



Western Forest Products Inc.
2013 Annual Report

Financial Highlights

	Year ended December 31,		
	2013	2012 ⁽⁵⁾	2011 ⁽⁶⁾
<i>(millions of Canadian dollars except ratios, per share and share amounts)</i>			
Revenue	977.5	925.4	853.7
Net income	125.4	28.2	14.3
Cash flow from operating activities	110.7	57.7	43.7
Basic net income per share	\$ 0.29	\$ 0.06	\$ 0.03
Diluted net income per share	\$ 0.28	\$ 0.06	\$ 0.03
Adjusted EBITDA ⁽¹⁾	128.8	51.0	61.6
Adjusted EBITDA as % of revenue	13.2%	5.5%	7.2%
Weighted average shares outstanding - Basic ('000's)	438,547	467,945	468,051
Weighted average shares outstanding - Diluted ('000's)	443,254	470,459	475,868
Working capital	124.5	120.0	123.7
Total assets	670.5	606.3	608.3
Net debt ⁽²⁾	82.9	15.0	52.1
Net debt to capitalization ⁽³⁾	0.18	0.04	0.13
Total liquidity ⁽⁴⁾	125.9	185.1	112.1

(1) See page 4 for definition of Adjusted EBITDA. A quantitative reconciliation between net income and Adjusted EBITDA can be found in Appendix A to the Management's Discussion and Analysis.

(2) Net debt is defined as the sum of long-term debt, current portion of long-term debt, revolving credit facility, less cash and cash equivalents.

(3) Capitalization comprises net debt and shareholders' equity.

(4) Total liquidity comprises cash and cash equivalents and available credit under the Company's revolving credit facility and revolving term loan.

(5) Restated to reflect implementation of revised IAS 19 - Employee Benefits.

(6) Not restated under IFRS for the amended IAS 19 - Employee Benefits.

Letter to Shareholders

To Our Shareholders,

I am pleased to report that our record financial results in 2013 enabled us to deliver superior returns to our shareholders while achieving a B.C. industry-leading Medical Incident Rate of 1.36.

We capitalized on improving markets, growing our EBITDA margins by 140%, realizing a record \$128.8 million of adjusted EBITDA. We continued the implementation of our balanced approach to capital allocation by using \$110.7 million generated from operations to build our business, investing \$59.0 million in capital improvements while distributing more than \$15 million in dividends to our shareholders. In addition, we paid down \$45.0 million of long term debt and used our strong balance sheet to repurchase \$100.3 million of our shares.

In the past year, our ownership was transformed through three secondary share offerings. New shareholders now comprise more than 40% of the ownership of the Company. I would like to take this opportunity to welcome these new shareholders and emphasize our on-going commitment to delivering superior long term returns.

Western's 2013 financial highlights included:

- Adjusted EBITDA for the year of \$128.8 million, the highest in company history
- Shareholder returns of 47%
- Liquidity remained strong at \$125.9 million

In addition to these positive financial results, Western realized several operational achievements in 2013 including:

- B.C. industry-leading Medical Incident Rate of 1.36, the lowest in company history
- Margin improvement program delivered a further \$14.2 million in annualized benefits
- Sawmill production was 5% higher and productivity per shift improved by 2%

I am pleased to announce that our Board of Directors has appointed Lee Doney as Chairman of Western's Board. Mr. Doney joined the Board in July 2004, and has served as our Vice-Chair since November 2008. During this time, he helped lead the successful execution of our business strategy and provided valuable strategic guidance and oversight to management.

Dominic Gammiero will step down from our Board after serving as Chairman since 2009, as a Director since 2006 and a member of the senior executive team since 2008. I want to recognize and thank Dominic for his extraordinary vision and innovative leadership, which resulted in the transformation of Western into one of Canada's leading forest products companies. Indeed, Dominic is credited with restructuring our operations, redefining our business and guiding our organization to deliver significant and sustained value to our shareholders.

Our outlook continues to be very positive. The recovery in the U.S. new home segment is well underway and is underpinning rising global demand for lumber and logs. U.S. housing starts increased more than 18% in 2013 and are projected to grow a further 22% this year. Improving lumber demand in the U.S. will drive pricing for our commodity and Cedar product lines. Our revenues will further benefit from the weakening Canadian dollar.

Growth in China is expected to continue. Forest product demand in China is being supported by large scale government investments in infrastructure and housing. With both China and the U.S. competing for a constrained supply of lumber and logs, we can expect prices to rise further in 2014.

We also expect to see increased demand and higher pricing for specific products in Japan. As the U.S. market improves, we anticipate U.S. Pacific Northwest suppliers will redirect some volume back to their home market which will create opportunity for Western. Our improved cost structure, resulting from our capital investments, will allow us to increase volume into this market.

Our 2014 business plan is focused on leveraging improved markets to deliver even better financial results. We will fully utilize our log markets and flexible lumber manufacturing base to refine our product mix to drive margins higher. We are well positioned to capitalize on the spring building season with an improved log inventory compared to last year.

We are pursuing growth by accessing additional log supply. Internally, we will increase the availability of logs from our own tenures by recovering more sawable fibre from low value pulp logs. Externally, we will access more volume by building upon our mutually beneficial partnerships with First Nations and by increasing purchases. Our ability to attract external log volume is made possible by our capital investments, which have delivered a more competitive operating platform.

Growth will also come from our strategic capital investments which are performing above expectations. In 2014, we will benefit from the first phase of our Saltair sawmill project, the autograder at our Alberni Pacific sawmill, and the upgraded planer at Cowichan Bay. Encouraged by the initial returns from these projects, which will surpass 30%, we anticipate investing a further \$40 million in targeted high return strategic capital projects in 2014.

As we grow the business, we will remain an industry leader with respect to safety. We are proud of the progress we have made in safety and remain resolute in our commitment to further improve the safety of our operations by identifying and managing hazards while implementing improved standards. Along with industry peers, we are developing a best-in-class suite of solutions to manage the hazards of sawmill dust. In 2014, we will continue to invest our resources in training, particularly for new workers joining the industry.

We are confident we will continue to improve our financial results. We continue to build a strong management team that is committed to delivering improved results and shareholder value. Coupled with our strong balance sheet and margin-focused growth strategy, we are well positioned to capitalize on increased demand for our log and lumber products.

I would like to thank our shareholders, customers, employees and communities for their continued support of Western Forest Products.



Don Demens
President and CEO

Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") reports and comments on the financial condition and results of operations of Western Forest Products Inc. ("Company", "Western", "us", "we", or "our"), on a consolidated basis, for the year ended December 31, 2013 to help security holders and other readers understand our Company and the key factors underlying our financial results. This discussion and analysis should be read in conjunction with the audited annual consolidated financial statements and related notes thereto, for the years ended December 31, 2013 and 2012, which can be found on SEDAR at www.sedar.com.

The Company has prepared the financial information contained in this discussion and analysis in accordance with International Financial Reporting Standards ("IFRSs"), as issued by the International Accounting Standards Board.

Reference is made in this MD&A to adjusted EBITDA¹. Adjusted EBITDA is defined as operating income prior to operating restructuring items and other income (expenses), plus amortization of property, plant, equipment and intangible assets, impairment adjustments, and changes in fair value of biological assets. Western uses adjusted EBITDA as a benchmark measurement of our own operating results and as a benchmark relative to our competitors. We consider adjusted EBITDA to be a meaningful supplement to operating income as a performance measure primarily because amortization expense, impairment adjustments and changes in the fair value of biological assets are non-cash costs, and vary widely from company to company in a manner that we consider largely independent of the underlying cost efficiency of their operating facilities. Further, the inclusion of operating restructuring items which are unpredictable in nature and timing may make comparisons of our operating results between periods more difficult. We also believe adjusted EBITDA is commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

Adjusted EBITDA does not represent cash generated from operations as defined by IFRSs and it is not necessarily indicative of cash available to fund cash needs. Furthermore, adjusted EBITDA does not reflect the impact of a number of items that affect our net income. Adjusted EBITDA is not a measure of financial performance under IFRSs, and should not be considered as an alternative to measures of performance under IFRSs. Moreover, because all companies do not calculate adjusted EBITDA in the same manner, adjusted EBITDA as calculated by Western may differ from EBITDA as calculated by other companies. A reconciliation between the Company's net income as reported in accordance with IFRSs and adjusted EBITDA is included in Appendix A to this report.

Also in this MD&A, management uses key performance indicators such as net debt, net debt to capitalization and current assets to current liabilities. Net debt is defined as long-term debt less cash and cash equivalents. Net debt to capitalization is a ratio defined as net debt divided by capitalization, with capitalization being the sum of net debt and shareholder's equity. Current assets to current liabilities is defined as total current assets divided by total current liabilities. These key Performance indicators are non-GAAP financial measures that do not have a standardized meaning and may not be comparable to similar measures used by other issuers. They are not recognized by IFRSs, however, they are meaningful in that they indicate the Company's ability to meet their obligations on an ongoing basis, and indicate whether the Company is more or less leveraged than the prior year.

This MD&A contains statements which constitute forward-looking statements and forward-looking information within the meaning of applicable securities laws. Those statements and information appear in a number of places in this document and include statements and information regarding our current intent, belief or expectations primarily with respect to market and general economic conditions, future costs, expenditures, available harvest levels and our future operating performance, objectives and strategies. Such statements and information may be indicated by words such as "estimate", "expect", "anticipate", "plan", "intend", "believe", "should", "may" and similar words and phrases. Readers are cautioned that it would be unreasonable to rely on any such forward-looking statements and information as creating any legal rights, and that the statements and information are not guarantees and may involve known and unknown risks and uncertainties, and that actual results and objectives and strategies may differ or change from those expressed or implied in the forward-looking statements or information as a result of various factors. Such risks and uncertainties include, among others: general economic conditions, competition and selling prices, changes in foreign currency exchange rates, labour disruptions, natural disasters, relations with First Nations groups, changes in laws, regulations or public policy, misjudgments in the course of preparing forward-looking statements or information, changes in opportunities and other factors referenced under the "Risk Factors" section in our MD&A in this annual report. All written and oral forward-looking statements or information attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing cautionary statements. Except as required by law, Western does not expect to update forward-looking statements or information as conditions change.

Unless otherwise noted, the information in this discussion and analysis is updated to February 20, 2014. Certain prior period comparative figures have been reclassified to conform to the current period's presentation. All financial references are in millions of Canadian dollars unless otherwise noted.

¹ Earnings Before Interest, Tax, Depreciation and Amortization

Overview

Western reported strong financial results for 2013, reflecting continued growth of the Company. Total revenue of \$977.5 million was 6% higher than one year ago, while adjusted EBITDA margins increased to 13.2% from 5.5% in 2012. Adjusted EBITDA for the year was \$128.8 million, the best annual adjusted EBITDA result in our history, and an increase of \$77.8 million over the comparable figure for 2012. Our improved adjusted EBITDA result was driven by stronger product demand leading to improved pricing, for both our lumber and log sales, as well as continued execution on the part of our operations. Average realized prices during 2013 for lumber and logs were higher by 8% and 21%, respectively, over last year.

Improved demand for our lumber and logs was driven by increased housing starts in the United States ("US") and Japan, and increased government investment in infrastructure and housing in China. 2013 housing starts in the US were 923,400 units, which was 18% higher than in 2012. North American benchmark Western Spruce/Pine/Fir 2x4 #2&Btr ("SPF") prices were on average 19% higher during 2013 compared to 2012. Western Red Cedar ("WRC"), whitewood specialty lumber and commodity lumber prices were all significantly higher this year. Log markets in 2013 continued to reflect strong demand with prices for domestic sawlogs and export logs higher than in 2012.

In anticipation of more robust markets, our operations group moved log volume quickly through our supply chain, supplying logs to our mills to optimize production levels, and also delivering a higher value log mix to external markets. We increased our sawlog availability through purchases in the open market and with more aggressive log sorting. Our log harvest volume was at normal levels in 2013, but 12% lower when compared to 2012. In 2012, we accelerated harvesting in order to capture undercut volumes from previous years.

Net income of \$125.4 million in 2013 was an increase of \$97.2 million over our 2012 net income of \$28.2 million. In addition to the \$77.8 million increase in adjusted EBITDA generated in 2013, we recognized a deferred income tax asset of \$26.5 million associated with our available tax losses.

Our liquidity position remains strong. At December 31, 2013, we had total liquidity of \$125.9 million, compared to \$185.1 million at the end of 2012. During 2013, we utilized \$100.3 million of liquidity to finance a share repurchase, and also repaid \$45.0 million of debt from surplus cash generated by operations.

Our strategic capital plan continues to progress well. We completed the first phase of our Saltair sawmill project during 2013. Construction will commence on the next phase of this project, which involves the installation of a new log in-feed, during the second quarter of 2014. We expect the full benefits from the project to commence by the fourth quarter of 2014. The Albern Pacific sawmill autograder was installed at the end of 2013 and is operating as expected. Our Cowichan Bay capital upgrade consists of two phases. The first phase, a planer upgrade, was completed in late 2013, and the second phase, a log auto-rotation project, will be installed early in the third quarter of 2014.

During 2013, our non-capital margin improvement plan program contributed \$14.2 million in annualized margin enhancements. These benefits mainly relate to manufacturing throughput improvements, along with timberlands, logistics and procurement initiatives.

On August 16, 2013, the Company closed a substantial issuer bid, repurchasing 76,923,076 outstanding shares for a purchase price of \$1.30 per share, for gross aggregate consideration of \$100.0 million excluding transaction costs, which was financed from funds drawn on our revolving term loan facility. These shares represented approximately 16% of the total number of shares issued and outstanding as of August 16, 2013. 76,914,830 of the shares were repurchased from Brookfield Special Situations Management Limited ("BSSML") for consideration of approximately \$100.0 million. Immediately following the repurchase, the Company converted 36,800,000 Non-Voting Shares held by BSSML, on a one-for-one basis, into Common Shares of the Company.

On October 9, 2013 and January 31, 2014 the Company closed two secondary offerings of the Company's shares by BSSML. As a result, all of the remaining 85,050,597 Non-Voting Shares of the Company were converted, on a one-for-one basis, into Common Shares of the Company. Following these transactions BSSML held no Non-Voting Shares and 163,012,474 Common Shares, representing approximately 42% of the issued and outstanding Common Shares on a non-diluted basis.

The substantial issuer bid and the BSSML secondary offerings have both been positive for Western's shareholders, and have led to a significant increase in the public float of our Common Shares from approximately \$80 million in December 2012 to \$540 million in January 2014. In addition, the average daily trading volume of our shares increased by approximately five times over the same period.

During 2013, we initiated a quarterly dividend program and paid our first two dividends of \$0.02 per share in each of September and December 2013.

On January 28, 2013, we entered into a conditional sale agreement for the sale of our former Woodfibre Pulp Mill site for net proceeds of approximately \$18.0 million. Closing of the sale is subject to certain conditions, and we are responsible for the satisfactory remediation of the property to applicable environmental standards prior to closing the sale. The remediation plan is in progress, and we anticipate achieving the required environmental certification early in 2015. As economic and other circumstances allow, we will continue to pursue opportunities to sell other non-core assets.

Selected Annual Information ⁽¹⁾

	Year ended December 31,		
	2013	2012 Restated ⁽²⁾	2011 ⁽³⁾
<i>(millions of dollars except per share amount)</i>			
Revenue	\$ 977.5	\$ 925.4	\$ 853.7
Adjusted EBITDA ⁽²⁾	128.8	51.0	61.6
Adjusted EBITDA as % of revenue	13.2%	5.5%	7.2%
Operating income prior to restructuring items and other income (expense)	105.5	37.7	35.0
Net income from continuing operations	125.9	29.3	24.9
Net income for the period	125.4	28.2	23.8
Basic earnings per share (in dollars)	\$ 0.29	\$ 0.06	\$ 0.05
Diluted earnings per share (in dollars)	\$ 0.28	\$ 0.06	\$ 0.05
Total Assets	\$ 670.5	\$ 606.3	\$ 608.3
Net Debt ⁽⁴⁾	\$ 82.9	\$ 15.0	\$ 52.1

⁽¹⁾ Included in Appendix A is a table of selected results for the last eight quarters.

⁽²⁾ Restated to reflect implementation of revised IAS 19 - Employee Benefits as described on page 15.

⁽³⁾ Not restated under IFRS for the amended IAS 19 - Employee Benefits.

⁽⁴⁾ Net debt is defined as the sum of long-term debt, current portion of long-term debt, revolving credit facility, less cash and cash equivalents (show as nil if net cash).

Operating Results

	Year ended December 31,	
	2013	2012
<i>(millions of dollars)</i>		
Revenues		
Lumber	\$ 677.2	\$ 624.4
Logs	243.8	246.3
By-products	56.5	54.7
Total revenues	977.5	925.4
Adjusted EBITDA	128.8	51.0
Adjusted EBITDA as % of revenues	13.2%	5.5%

Adjusted EBITDA for 2013 was \$128.8 million, which is an increase of \$77.8 million over the \$51.0 million earned in 2012. The higher adjusted EBITDA primarily reflects improved prices for our products in 2013 due to improving demand for lumber and logs. The stronger markets in 2013 have allowed us to maximize margins by improving product mix. Our results in 2013 also benefited from reduced lumber freight costs and export taxes, as well as the beneficial impact on our revenues of the relative weakening of the Canadian dollar against the US dollar, which was, on average, 3% lower during 2013. Partially offsetting these positive improvements to adjusted EBITDA were the impacts of lower log harvest levels and the resulting lower shipment volumes of logs, higher unit log costs, and the negative impact of the weakening Japanese yen against the Canadian dollar.

Lumber revenue in 2013 was \$677.2 million, 8% higher than in 2012. This increase was driven principally by increased prices, as we shipped 895 million board feet (“mmfbm”) of lumber in 2013, similar to the volume shipped last year. Our average realized price for lumber during 2013 was \$58 per thousand board feet, or 8%, higher than in 2012. The increase in housing starts in the US during 2013 supported stronger lumber demand. WRC, whitewood specialty lumber and commodity lumber prices were all higher this year compared to 2012. There was also a geographic mix change year-over-year, as our shipments to China increased by 32% over 2012 levels. China shipments represented 34% of our total shipments compared to 24% last year. Our lumber sales volumes to Canada and Japan fell by 20% and 12%, respectively, in 2013 as compared to 2012.

Log revenues in 2013 declined by \$2.5 million, or 1%, from 2012. The benefits of increased log pricing and a favourable product mix change in 2013 over 2012 were offset by the impact of a decline in the volume of log shipments this year. Log sales volumes declined by 661,000 cubic metres, or 19%, in 2013 compared to 2012. The reduction in our volumes sold is mainly the result of our reduced harvest levels in 2013 compared to 2012, although this impact was partially mitigated by increased log purchases. Log market demand was stronger in 2013 compared to 2012, and, combined with the continued tight log supply on the coast, prices were driven higher. The overall average price of logs sold in 2013 was \$15 per cubic metre, or 21%, higher than in 2012. In addition to higher log prices, our overall average price realized further increased because of a favourable change in the mix of our sales. As markets improved during 2013, we were successful in directing lower valued logs into higher value end uses, which has contributed to enhancing our adjusted EBITDA.

Sales of by-products in 2013 were \$56.5 million, or \$1.8 million higher than in 2012. Average chip prices realized were 6% higher in 2013 compared to 2012, the benefit of which was partially offset by 3% lower volume sold in 2013. Contributing to the price increase was the beneficial mix impact of selling proportionately higher volumes of more expensive hemlock/balsam chips. In general, chip prices are tied by a formula to the market price of pulp, and for 2013 these pulp prices were higher than 2012 (northern bleached softwood kraft prices delivered to China were 5% higher in 2013 than in 2012).

Total freight costs in 2013 were \$82.0 million, which is \$6.2 million less than those incurred for 2012. Our freight costs for lumber were reduced by \$7.7 million, which was partly offset by an increase in log freight costs of \$1.5 million. Our shipment volumes of lumber were almost identical year-over-year, with the cost reduction resulting from a change in the geographic mix of our shipments. In 2013, we shipped 59% of our lumber within the North American market compared to 54% in 2012, with a corresponding reduction in direct shipment levels to the Asian market, which incur higher freight costs. The increase in log freight costs was the result of more shipments being made during 2013 with terms under which Western was responsible for the freight costs compared to 2012.

Primary saw mill production for 2013 was 772 mmfbm, 5% higher than during 2012. The increased production level was achieved by operating 3% more shifts this year. In addition, our mill productivity, measured on a production per shift basis, increased by 2% over 2012, even though our production per shift in 2013 was negatively impacted by downtime taken at our Saltair sawmill to install new equipment. Through 2013, we faced the challenge of a constrained log supply on the coast, but addressed the issue by running a broader species and quality mix. Despite running this broader mix, productivity and lumber recoveries both showed improvement year-over-year.

The total log harvest for 2013 was 5.4 million cubic metres, which was 11% lower than the 2012 harvest level of 6.1 million cubic metres. The decline in 2013 reflects accelerated harvesting undertaken in 2012 in order to capture previous year’s undercut volumes. This volume reduction led to an increase in our fixed per unit costs of harvest production, and to meet our operational needs in 2013 we increased our log purchase program. We increased log purchases on the open market, entered various standing timber purchase agreements, and established joint venture arrangements with third parties, including First Nations, to gain access to additional logs. Our overall harvest costs were higher in 2013 as a result of increased spur road construction costs and additional engineering costs. Partially offsetting these increased costs were proportionately lower volumes of high cost heli-logging this year compared to last year, lower levels of fixed rate contract harvest volume in 2013, and increased use of our own crews for harvesting.

Selling and administration expenses in 2013 were \$33.0 million (2012: \$28.6 million). The \$4.4 million increase is largely because of increases in performance related employee compensation. As a

percentage of revenues our selling and administration costs were 3.4% for 2013, an increase from the 3.1% reported in 2012.

Reversal of impairments

During 2013, Western recorded a reversal of previously recognized impairments of \$8.2 million on its Crown timber tenures (2012: \$12.9 million). This resulted from an annual value-in-use assessment performed in December 2013 on the carrying amount of the Crown tenures. The reversal was the result of increases to the net present values of projected cash flows generated from the Crown tenures, primarily due to the beneficial impact of improved markets for our products.

Operating restructuring items

In 2013, Western recorded restructuring expenses of \$0.7 million, all of which related to severance costs. This compares to an equivalent expense of \$4.8 million in 2012, the majority of which related to \$4.0 million incurred to restructure harvesting operations in TFL 44 in order to improve operating performance in the future. The balance of \$0.8 million related to severance costs incurred with respect to departmental reorganizations.

Finance costs

Finance costs of \$5.4 million for 2013 were \$0.9 million less than the \$6.3 million incurred in 2012. The decrease was primarily the result of the lower interest expense on our revolving term loan facility, which resulted from lower average interest rates in 2013, and lower average outstanding debt levels during 2013 compared to 2012. During 2013, Western repaid \$45.0 million on the revolving term loan from surplus cash primarily generated from operations, and in June 2013, drew \$100.0 million on the extended revolving term loan to finance the share repurchase. Also, fewer deferred financing costs were amortized in 2013 compared to last year.

Other income

Other income of \$0.3 million was reported in 2013, a decrease of \$2.5 million from the income of \$2.8 million earned in 2012. The most significant items that comprised the other income of \$0.3 million in 2013 were net gains on non-core property sales of \$1.5 million, mostly offset by building demolition costs incurred during the year. In 2012, other income was comprised of net gains on non-core asset disposals in the year of \$1.1 million, proceeds of \$1.1 million received as final compensation from the Province of British Columbia resulting from the creation of new protective areas in our Haida Gwaii and Central Coast operating areas, and other miscellaneous items aggregating to \$0.6 million.

Income taxes

At December 31, 2013, the Company and its subsidiaries had non-capital tax losses carried forward totaling approximately \$308.2 million, which expire between 2027 and 2033, and can be used to reduce taxable income. In addition, the Company has capital losses of approximately \$121.7 million, which are available indefinitely, but can only be utilized to offset future tax based capital gains. During 2013, the Company recognized a deferred income tax asset of \$26.5 million with respect to part of its non-capital tax losses, as management has concluded that it is probable that future taxable profits will be available against which this tax asset can be utilized. While the Company anticipates realizing the additional benefit of the remaining unrecognized loss carry forwards and other deferred income tax assets, the timing of such recognition will depend on on-going assessments of economic conditions, and that the likelihood of the Company's ability to utilize the losses is probable.

Net income from continuing operations

Net income from continuing operations in 2013 increased from the prior year figure by \$96.6 million to \$125.9 million. This increase is primarily driven by the \$77.8 million increase in adjusted EBITDA in 2013 as discussed above. In addition, the 2013 net income includes the recognition of a deferred income tax asset and associated income tax recovery of \$26.5 million as described above, whereas none was

recognized in 2012. Other positive variances include lower restructuring costs by \$4.1 million in the current year and lower finance costs by \$0.9 million.

Discontinued Operations

Operations on the site of the former Squamish pulp mill were discontinued in 2006. Since that date, the Company has expensed costs for supervision, security, property taxes and environmental remediation. In 2013, the Company incurred a net expense of \$0.5 million with respect to the site, compared to \$1.1 million in 2012. The reduction in the net expense in the current year is primarily attributable to revenue from selling hydro-electric power generated at the site, which commenced in the second half of 2013.

In January 2013, Western entered into a conditional agreement for the sale of the site for a gross purchase price of \$25.5 million. Closing of the sale is subject to certain conditions, and Western is responsible for the satisfactory remediation of the property to applicable environmental standards. After incurring the estimated required remediation costs, Western anticipates receiving net proceeds from the sale and remediation of approximately \$18.0 million. As economic and other circumstances allow, Western will continue to pursue opportunities to sell non-core assets.

Financial Position and Liquidity

	Year ended December 31,	
	2013	2012
<i>(millions of dollars except where noted)</i>		
Cash provided by operating activities	\$ 110.7	\$ 57.7
Cash used in investing activities	(55.7)	(15.1)
Cash used in financing activities	(65.0)	(38.0)
Cash used to construct capitalized logging roads	(15.4)	(11.1)
Cash used to acquire property, plant and equipment	(43.6)	(20.9)
	December 31,	December 31,
	2013	2012
Total liquidity ⁽¹⁾	\$ 125.9	\$ 185.1
Net debt ⁽²⁾	82.9	15.0
Financial ratios:		
Current assets to current liabilities	2.34	2.30
Net debt to capitalization ⁽³⁾	0.18	0.04

⁽¹⁾ Total liquidity comprises cash and cash equivalents and available credit under the Company's revolving credit facility and revolving term loan.

⁽²⁾ Net debt is defined as the sum of long-term debt, current portion of long-term debt, revolving credit facility, less cash and cash equivalents (show as nil if net cash).

⁽³⁾ Capitalization comprises net debt and shareholders equity

Cash provided by operating activities in 2013 amounted to \$110.7 million, an increase of \$53.0 million over the \$57.7 million provided in 2012. Cash generated by operating activities before working capital changes was \$123.9 million, which was \$81.9 million more than in 2012, primarily reflecting the increased adjusted EBITDA earned in the current year. Partially offsetting this increase was a reduction of \$28.9 million in cash generated from working capital changes over the respective years. This is largely driven by a significant reduction in inventory levels at the end of 2012 compared to those at the end of 2011 and 2013. Inventories of logs, in particular, were lower at the end of 2012, primarily as a result of unusually high shipments in the latter part of the fourth quarter of 2012. We have been successful in building sawlog inventory at the end of 2013, in anticipation of strong markets in 2014.

Cash of \$55.7 million was used in investing activities in 2013, compared to \$15.1 million invested in 2012. The increase is mostly the result of an increase in our capital expenditure levels in 2013 compared to 2012, and less cash received from non-core asset sales this year. Our capital expenditures in 2013 increased to \$59.0 million, reflecting increases in both our strategic and maintenance capital investments. In 2013, our strategic capital investments increased to \$21.5 million, and spending on capital roads and other maintenance projects increased over 2012 levels to \$22.1 million and \$15.4 million, respectively. The majority of the strategic capital invested related to our Saltair sawmill upgrade and Alberni Pacific

sawmill auto-grading project. The strategic capital program is discussed more fully in the “Strategy and Outlook” section.

Financing activities in 2013 used cash of \$65.0 million compared to \$38.0 million in 2012. During 2013, Western paid \$100.3 million to repurchase 49,862,642 Non-Voting and 27,060,434 voting Common Shares, utilizing cash of \$100.0 million drawn on its revolving term facility. During the third and fourth quarters of 2013, we paid two quarterly dividends to shareholders, each at \$0.02 per share, totaling \$15.6 million, and repaid \$45.0 million on the revolving term loan facility with surplus cash generated from operations. Interest paid in 2013 was \$3.5 million compared to \$4.0 million paid in 2012, mainly as a result of a lower average interest rate on the revolving term facility, and lower average debt levels outstanding over the course of 2013 compared to 2012.

At December 31, 2013, we had total liquidity of \$125.9 million, compared to \$185.1 million at the end of 2012. During 2013, we utilized \$100.3 million of liquidity to finance a share repurchase, and we repaid \$45.0 million of debt from surplus cash generated by operations. Liquidity is comprised of cash of \$5.6 million, unused availability under the secured revolving credit line of \$100.1 million, and \$20.2 million under the revolving term loan. Based on our current forecasts, we expect sufficient liquidity will be available to meet our obligations in 2014.

Fourth Quarter Results

	Three months ended December 31,	
	2013	2012 Restated ⁽²⁾
<i>(millions of dollars except per share amount)</i>		
Revenue	\$ 242.0	\$ 231.2
Adjusted EBITDA ⁽²⁾	24.4	14.3
Adjusted EBITDA as % of revenue	10.1%	6.2%
Operating income prior to restructuring items and other income (expense)	24.9	21.0
Net income from continuing operations	49.9	14.5
Net income for the period	49.9	14.3
Basic earnings per share (in dollars)	\$ 0.13	\$ 0.03
Diluted earnings per share (in dollars)	\$ 0.13	\$ 0.03

⁽¹⁾ Included in Appendix A is a table of selected results for the last eight quarters.

⁽²⁾ Restated to reflect implementation of revised IAS 19 - Employee Benefits as described on page 15.

We saw an overall improvement in market conditions in the fourth quarter of 2013 relative to the fourth quarter of 2012. Historically, lumber prices decrease in the fourth quarter as seasonal demand declines. However, as in 2012, North American commodity lumber prices increased during the quarter, along with WRC, and other higher grade lumber. Log prices were also higher in the fourth quarter of 2013 compared to 2012.

We reported adjusted EBITDA of \$24.4 million in the fourth quarter of 2013, an increase of \$10.1 million over the fourth quarter of 2012. The increase in adjusted EBITDA resulted from higher average realized prices on log and lumber sales, partially offset by lower volumes of log sales and increased costs in our timberlands operations. Revenues were higher by \$10.8 million, or 5%, in the fourth quarter of 2013 compared to the fourth quarter of 2012. Lumber and by-products revenues were higher with a small decline in log revenues.

Lumber shipment volumes were the same in both quarters at 222 million board feet, but average realized prices were 8% higher this quarter with WRC, hemlock and Douglas fir price realizations all being higher, driven by strengthening demand.

Log revenue in the fourth quarter of 2013 was \$3.2 million lower than the same quarter in 2012. Shipment volumes were 138,000 cubic metres, or 17%, less in fourth quarter of 2013 compared to the same quarter in 2012. However, offsetting the impact of lower volumes was the benefit of higher average prices and a more favourable mix of products sold. Fourth quarter 2013 realized prices were higher, on average, by 15% over the fourth quarter of 2012 with increases for export logs, hemlock sawlogs, and peeler logs. Operations were also able to improve the mix of our sales by diverting pulp logs into hemlock sawlog sorts. By-product revenues were \$2.0 million higher this quarter compared to the fourth

quarter of 2012, principally as a result of average chip prices being 17% higher this quarter compared to 2012, which reflects improvements in global pulp prices.

Sawmill production in the fourth quarter of 2013 was 13% higher than the fourth quarter 2012, mainly due to being able to run extra shifts in the fourth quarter this year, in part due to greater log availability. In addition, mill productivity as measured on a production per shift basis, was 3% higher this quarter compared to the fourth quarter of 2012.

Our timberlands harvest volume for the fourth quarter of 2013 was 1,314,000 cubic metres, which was 8% lower than our harvest in the same quarter of 2012. In 2013, our harvest costs were higher by approximately \$7 per cubic metre than in the fourth quarter of 2012, which was partially reflective of the increased logging activity in higher cost locations, and increased helicopter logging this quarter. Spending on spur road construction increased as we built more roads in the fourth quarter of 2013 compared to last year. We also increased log purchases in the current quarter relative to 2012 in order to supply more volume to meet our manufacturing needs.

In the fourth quarter of 2013, the Canadian dollar weakened against the US dollar by approximately 6%, but was 14% stronger relative to the Japanese Yen, compared to the rates for the fourth quarter of 2012. The strengthening US dollar had a positive impact on our results, whereas the weakening Yen had a negative effect in the current quarter compared to the same quarter in 2012.

Selling and administration expenses in the fourth quarter of 2013 were \$8.8 million, which was \$2.0 million higher than the fourth quarter of 2012. This increase is mostly attributable to performance related employee compensation costs incurred in the current quarter.

Net income of \$49.9 million reported in the fourth quarter of 2013 was an increase of \$35.6 million over the income of \$14.3 million reported for the same quarter of 2012. The improvement was primarily due to the higher adjusted EBITDA earned in the current quarter, combined with the deferred income tax recovery of \$26.5 million recognized in the fourth quarter of 2013. Operating restructuring items were \$4.1 million lower in the fourth quarter of 2013 compared to the fourth quarter of 2012, as that year included \$4.0 million expensed as a result of restructuring harvesting operations in TFL 44 in order to improve its operating performance in the future.

Other expenses in the fourth quarter of 2013 of \$0.1 million compared to other expenses of \$0.9 million in the fourth quarter of 2012. Included in the fourth quarter of 2012 was a net loss on non-core asset sales of \$1.5 million, partially offset by income of \$0.9 million received from the Province of British Columbia for costs incurred by Western relating to the Sliammon First Nations Treaty.

Finance costs in the fourth quarter of 2013 were \$1.7 million which was \$0.3 million higher than the same quarter of 2012, primarily as a result of higher average debt levels in the current quarter. This was partly offset by lower finance costs associated with our deferred pension plan in the fourth quarter of this year.

Following impairment assessments made on our crown tenures in the fourth quarters of both 2013 and 2012, we recognized impairment reversals of \$8.2 million and \$12.9 million, respectively, as described earlier in this report in the "Operating Results" section.

Strategy and Outlook

We continued to make progress on our margin focused growth strategy in 2013. Our strong balance sheet and free cash flows allowed us to complete a \$100.0 million share repurchase in the third quarter of 2013, and initiate a regular quarterly dividend. At the same time, we continued with the implementation of our strategic capital investment plan. We will continue to implement our margin focused growth strategy by maximizing product margins and increasing our sales volumes in an improving global market for our products. Our long term strategic goals for the Company remain:

- Fully utilizing our Allowable Annual Cut and ensuring the highest margin end use for our fibre resources;
- Optimizing utilization of our sawmill assets, realizing full economies of scale;
- Growing market share in traditional and developing markets; and
- Generating substantial free cash flow that justifies reinvestment and further growth.

Western's business plan for 2014 is focused on prudently growing the business to meet rising demand. The improved log and lumber markets are creating an opportunity for Western to increase margins as we utilize our flexible manufacturing base to refine our product mix. As demand improves, we will direct our sale volumes to the best margin opportunities.

Market Outlook

The steady recovery of the US new home construction segment and continued growth in demand for forest products in China is expected to drive increased consumption in 2014. Constrained supply from traditional sources such as BC's mountain pine beetle impacted regions and reduced allowable cut levels from eastern Canada will lead to improved pricing and higher degrees of volatility.

An improving US home construction segment has increased demand for our WRC product line, particularly in the repair and renovation sector. Sales volumes and values of WRC, which typically decline in the fourth quarter, have remained strong. Heading into the 2014 building season, the combination of increased seasonal demand and tight inventories is expected to support improved prices for WRC. Improved demand in the US for all lumber products is expected to reduce the likelihood of export taxes being applied to all shipments to the US, including WRC, in 2014.

Home construction in Japan accelerated in 2013, driven by government stimulus and an increase in consumption tax. Well balanced inventories should support the market through the first part of 2014. We expect our improved cost structure to allow us to increase volumes into the market in 2014.

Improving demand in North America will create greater opportunity for specialty industrial and appearance products. The increased demand is expected to drive prices higher, increasing market opportunities. Volumes are also expected to increase from 2013 levels.

Our commodity lumber segment benefited from increased demand from both North America and China in 2013. Our realized pricing improved by more than 30% compared to the 19% increase in the North American benchmark SPF commodity price. We expect demand to continue to improve in 2014 for our commodity products as growth in the US housing market is reviving product demand in that market. Demand in China is expected to remain strong due to additional government infrastructure and urban housing investments.

Strong demand in both export and domestic log markets is expected to continue through 2014. Growth in China, in particular, will drive increased demand for export logs. Log sales volumes are expected to increase in 2014 along with our aggressive procurement strategy. Market fundamentals for pulp logs have improved marginally, and we will continue to maximize sawlog production from pulp log sorts to increase our margins.

Strategic Capital Plan Update

We previously announced a \$125.0 million strategic plan focused on reducing costs, increasing efficiencies, and improving product flexibility. To date, we have initiated \$50.0 million of these investments and expect to announce a further \$25.0 million in additional investments in 2014.

We completed the first phase of our \$38.0 million Saltair sawmill project during 2013. To date, approximately \$27.0 million of our planned improvements have been invested. This phase was focused on the back end of the mill and included a new sorter, trimmer and edgers. The installation was completed safely and on budget, and performance continues to improve towards target levels. The next phase of the project will involve the installation of a new log in-feed, with installation commencing in the second quarter of 2014. Once complete, our Saltair sawmill will become the largest single line sawmill on the BC coast.

Installation of the Alberni Pacific sawmill autograder took place in November 2013, completing the first phase of this project. It is expected to deliver higher man-day productivity through increases in operating speeds and lumber recoveries, as well as improve the accuracy of lumber grading. To date, we have invested \$3.8 million of the \$6.7 million project. The second phase will incorporate a new lumber trimmer with completion targeted for the fourth quarter of 2014. We will look to implement the new autograding technology at other mills.

Our Cowichan Bay planer upgrade was completed in December 2013, and is performing well, setting a production record in the first week of operation. A log auto-rotation project is also planned for this mill and will be installed in the late second or early third quarter of 2014.

Non-Core Assets Update

In January 2013, Western announced that it had entered into a conditional agreement for the sale of its former Woodfibre Pulp Mill site for a gross purchase price of \$25.5 million. The site, consisting of 212 acres of industrial waterfront land, is located on Howe Sound, southwest of Squamish, BC. Closing is subject to certain conditions, and Western will be responsible for the satisfactory remediation of the property to applicable environmental standards prior to closing the sale. During 2013, both parties agreed to a specific remediation plan, and a deposit of \$5.5 million was placed in trust by the purchaser which is non-refundable provided that Western completes the remediation in accordance with the terms of the sale agreement. The remediation program is well underway and is anticipated to be complete in early 2015. After incurring the estimated required remediation costs, Western anticipates receiving net proceeds from the sale and remediation of approximately \$18 million.

We will continue to pursue the sale of additional non-core assets as appropriate. Proceeds from such sales will first be directed to reduce or eliminate long-term debt with any surplus being used to provide additional liquidity.

Summary of Contractual Obligations

The following table summarizes our contractual obligations at December 31, 2013 and our payments due for each of the next five years and thereafter:

<i>(millions of Canadian dollars)</i>	Total	2014	2015	2016	2017	2018	Thereafter
Accounts payable and accrued liabilities	\$ 79.8	\$ 79.8	\$ -	\$ -	\$ -	\$ -	\$ -
Discontinued operations	0.6	0.6	-	-	-	-	-
Revolving term loan	89.8	-	-	-	89.8	-	-
Operating leases	15.9	3.6	2.9	2.0	1.3	1.2	4.9
Silviculture provision	31.7	12.3	5.2	3.2	2.1	1.7	7.2
Other long-term liabilities	1.4	1.1	0.1	0.1	0.1	-	-
Defined benefit pension plan funding obligation	12.7	2.3	2.3	0.8	0.8	0.8	5.7
	<u>\$ 231.9</u>	<u>\$ 99.7</u>	<u>\$ 10.5</u>	<u>\$ 6.1</u>	<u>\$ 94.1</u>	<u>\$ 3.7</u>	<u>\$ 17.8</u>

Critical Accounting Estimates

Silviculture Provision

Under BC law, we are responsible for reforesting areas that we log. These obligations are referred to throughout this MD&A as silviculture liabilities. We accrue our silviculture liabilities based on estimates of future costs at the time the timber is harvested. The estimate of future silviculture costs is based on a detailed analysis for all areas that have been logged and includes estimates for the extent of planting seedlings versus natural regeneration, the cost of planting including the cost of seedlings, the extent and cost of site preparation, brushing, weeding, thinning and replanting and the cost of conducting silviculture surveys. Our registered professional foresters conduct the analysis that is used to estimate these costs. However, these costs are difficult to estimate and can be affected by weather patterns, forest fires and wildlife issues that could impact the actual future costs incurred and thus result in material adjustments.

Valuation of Inventory

We value our log and lumber inventories at the lower of cost and net realizable value. We estimate net realizable value by reviewing current market prices for the specific inventory items based on recent sales prices and current sales orders. If the net realizable value is less than the cost amount, we will record a write-down. The determination of net realizable value at a point in time is generally both objective and verifiable. However, changes in product prices can occur suddenly, which could result in a material write-down in inventories in future periods.

Valuation of Accounts Receivable

We record an allowance for the collection of doubtful accounts receivable based on our best estimate of potentially uncollectible amounts. The best estimate considers past experience with our customer base and a review of current economic conditions and specific customer issues. The Company's general practice is to insure substantially all North American lumber receivables for 90% of value with the Export Development Corporation or Coface Canada, while all export sales are sold on either a cash basis or with secured instruments, which reduces the Company's exposure to bad debts.

Pension and Other Post Retirement Benefits

Western has various defined benefit and defined contribution plans that provide pension benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. The Company also provides other post-retirement benefits and pension bridging benefits to eligible retired employees. While our defined benefit plans were closed to new entrants in June, 2006 and no further benefits accrue under the plans effective December 31, 2010, we retain independent actuarial consultants to perform actuarial valuations of plan obligations and asset values, and advise on the amounts to be recorded in the financial statements. Actuarial valuations include certain assumptions that directly affect the fair value of the assets and obligations and expenses recorded in the financial statements. These assumptions include the discount rate used to determine the net present value of obligations, the return on plan assets used to estimate the increase in the plan assets available to fund obligations and the increase in future compensation amounts and medical and health care costs used to estimate obligations. Actual experience can vary materially from the estimates and impact the cost of our pension and post-retirement medical and health plans and future cash flow requirements.

Environmental Provisions

We disclose environmental obligations when known and accrue costs associated with the obligations when they are known and can be reasonably estimated. The Company owns a number of manufacturing sites that have been in existence for significant periods of time and, as a result, we may have unknown environmental obligations. However, until the sites are decommissioned and the plant and equipment are removed, a complete environmental review cannot be undertaken.

Contingencies

Provisions for liabilities relating to legal actions and claims require judgments using management's best estimates regarding projected outcomes and the range of loss, based on such factors as historical experience and recommendations of legal counsel. Actual results may vary from estimates and the differences are recorded when known.

Valuation of Land

On adoption of IFRSs, we elected to measure land at fair value at each annual reporting date, or more frequently in the event of a material change in circumstances. This requires an assessment of the fair value of all land holdings using a combination of independent third party valuations, recent comparable land sales, discounted cash flow analysis as well as considering other publicly available information such as recent market transactions on arm's length terms between willing buyers and sellers, and BC property assessments.

Valuation of Biological Assets

The Company values its biological assets at fair value less costs to sell. An annual valuation is performed by an independent third party based on recent comparatives of standing timber sales, direct and indirect costs of sustainable forest management, net present value of future cash flows for standing timber and log pricing assumptions. Significant assumptions are used in the preparation of the valuation and actual results may vary materially from estimates.

Impairments

Assets that are subject to amortization are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment losses are recognized in net income for the period for the amount by which the asset's carrying amount exceeds its recoverable amount. An impairment analysis requires the use of significant assumptions, including management and independent third party input.

Deferred Income Taxes

The recognition of deferred income tax assets requires an assessment of the availability of future taxable profit against which carry forward tax losses can be used. We estimate future income based on forecasts which includes a number of variables that can be unpredictable and cyclical in nature. Changes in product prices, in particular, can occur quite suddenly.

New accounting policies

Changes in accounting policies

Western has adopted the following new standards and amendments to standards, including any consequential amendments to other standards with a date of initial application of January 1, 2013:

- Amendments to IAS 19 *Employee Benefits*

The Company has adopted the amendments to IAS 19 *Employee Benefits* effective January 1, 2013, with retrospective application. The amendments to IAS 19 require any remeasurement gains or losses, including actuarial gains and losses to be recognized immediately and presented in other comprehensive income (loss), eliminating the option to recognize these amounts through net income (loss).

The amendments to IAS 19 also require one discount rate be applied to the net defined benefit asset or liability for the purposes of determining the interest element of the defined benefit cost and require the recognition of unvested past service cost awards into earnings immediately.

Under IAS 19, Western determines the net interest expense (income) on the defined benefit liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability, taking into account any changes to the net defined liability during the period as a result of contributions and benefit payments. Consequently, the net interest on the net defined benefit liability now comprises: interest cost on the defined benefit obligation, interest income on plan assets, and interest on the effect of the asset ceiling. Previously, interest income on the plan assets was determined based on long term expected rate of return, and recognized the net interest cost in net income through selling and administration expenses. The quantitative impact of the change is described in Note 17 to the 2013 Audited Financial Statements.

- IFRS 13 *Fair Value Measurement*

IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair values measurements when such measurements are required or permitted by other IFRSs. It unifies the definition of fair values as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It replaces and expands the disclosure requirements about fair value measurements in other IFRSs, including IFRS 7. As a result Western has included additional disclosure in this regard in its consolidated financial statements (see Notes 5, 6 and 18 to the 2013 Audited Financial Statements).

In accordance with the transitional provisions of IFRS 13, Western has applied the new fair value measurement guidance prospectively and has not provided any comparative information for new disclosures. Notwithstanding the above, the change had no significant impact on the measurement of Western's assets and liabilities.

New standards and interpretations not yet adopted

The following amended IFRS standards are not yet effective for the year ended December 31, 2013 and have not been applied in preparing these consolidated financial statements:

- IFRS 9, *Financial Instruments (2009 and 2010)*

IFRS 9 Financial Instruments (2009 and 2010) (“IFRS 9 (2009)” and “IFRS 9 (2010)”) will replace IAS 39 Financial Instruments: Recognition and Measurement (“IAS 39”). IFRS 9 (2009) uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 (2009) is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities.

IFRS 9 (2009) and IFRS 9 (2010) are effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. The impact of the adoption of this standard is still being assessed.

- IAS 32, *Offsetting Financial Assets and Liabilities*

The amendments to IAS 32 which are effective for years commencing on or after January 1, 2014, clarify the guidance as to when an entity has a legally enforceable right to set off financial assets and financial liabilities, and, clarify when a settlement mechanism provides for net settlement. The Company intends to adopt the amendments to IAS 32 in its consolidated financial statements for the year commencing January 1, 2014. The Company does not expect the amendments to have a material impact on the consolidated financial statements.

The following new or amended IFRSs became effective on January 1, 2013. However, they did not have a material impact on the annual consolidated financial statements of the Company:

IFRS 10 Consolidated Financial Statements

IFRS 11 Joint Arrangements

IFRS 12 Disclosure of Interests in Other Entities

Amendments to IAS 28 Investments in Associates and Joint Ventures

Financial Instruments, Off-Balance Sheet Arrangements, Foreign Exchange and Related Party Transactions

Financial instruments, which for Western consist primarily of debt instruments, are discussed elsewhere in this discussion and analysis.

Western has a program in place to reduce the impact of volatile foreign exchange rates on its net income. The Company utilizes derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange risk. Therefore, Western may purchase foreign exchange forward contracts or similar instruments to hedge anticipated sales to customers in the US and Japan. The Company does not utilize derivative financial instruments for trading or speculative purposes. Western will consider whether to apply hedge accounting on a case by case basis and if the instrument is not designated as a hedge, the instrument is be fair valued and marked to market each accounting period, with changes recorded in net income.

To further assist in mitigating this foreign exchange risk, the Company entered into an agreement in March 2009 with Brookfield Asset Management Inc. (“BAM”) to provide a foreign exchange facility (“Facility”) to the Company. The Facility, which is for a notional amount of up to US\$80.0 million, matures on March 31, 2014, and allows for forward transactions with a maximum term for each transaction of up to one year. The maturity date is subject to automatic annual renewal subject to BAM notifying the Company of its intention to cancel the facility at least 30 days prior to the anniversary date and to certain change of control provisions being invoked. The Facility is unsecured and is subject to a fee of 0.10% of

the notional amount per annum. The Company does not consider the credit risk associated with this Facility to be significant. During 2013, the Company entered into contracts under the Facility to sell US dollars and Japanese Yen (“JPY”) forward in order to mitigate a portion of this foreign currency risk. At December 31, 2013, the Company had forward contracts in place to sell US\$11.0 million and JPY 100 million (2012 – US\$42.0 million; JPY 400 million). A net loss of \$0.5 million was recognized on contracts which matured in the year (2012 - \$1.0 million), which is included in sales in the consolidated statement of comprehensive income.

Other than operating leases for vehicles, equipment and machinery, the Company does not have any off-balance sheet arrangements as at December 31, 2013.

In addition to the related party transactions identified elsewhere in this MD&A, the Company has or had certain arrangements with entities related to BAM to acquire and sell logs, lease certain facilities, provide access to roads and other areas, and acquire services including insurance, all in the normal course and at market rates or at cost. The following table summarizes purchases made and revenues received relating to these transactions:

	Year ended December 31,	
	2013	2012
Costs incurred for:		
Log purchases	\$ 15.8	\$ 11.5
Other	8.8	6.5
	<u>\$ 24.6</u>	<u>\$ 18.0</u>
Income received for:		
Log sales	\$ 14.8	\$ 7.9
	<u>\$ 14.8</u>	<u>\$ 7.9</u>

Related party liabilities at December 31, 2013 were \$1.2 million (December 31, 2012: \$0.1 million).

Key personnel of the Company include the executive management team and members of the Board of Directors. The compensation paid or payable to key personnel is shown below:

	Year ended December 31,	
	2013	2012
Salaries and directors' fees	\$ 2.9	\$ 2.7
Post-employment benefits	0.3	0.2
Share-based payments	2.3	0.9
	<u>\$ 5.5</u>	<u>\$ 3.8</u>

Risks and Uncertainties

The following risks and uncertainties may have a material adverse effect on our operations or our financial condition:

Variable Operating Performance, Product Pricing and Demand Levels

A key factor affecting Western's operating and financial performance is the price received for lumber, logs and other products. Prices for these products are highly cyclical and have fluctuated significantly in the past and may fluctuate significantly in the future. The markets for our products are also highly cyclical and are characterized by periods of excess product supply due to many factors, including:

- Additions/curtailments to industry capacity and production;
- Periods of insufficient demand due to weak general economic activity or other causes including weather factors;
- Customers experiencing reduced access to credit; and
- Inventory de-stocking by customers.

Product demand is influenced to a significant degree by economic activity at the global level. Additionally, although costs may increase, customers may not accept related price increases for those products. We are not able to predict with certainty market conditions and prices for our products. Western's results of operations depend upon the prices we receive for lumber, logs and chips, and deterioration in prices of, or demand for, these products could have a material adverse effect on our financial condition or results of operations. We cannot provide any assurance or prediction as to the timing and extent of any price changes. On an annualized basis and based on current operating metrics, we estimate that operating earnings would increase or decrease by approximately \$9 million with a price increase or decrease, respectively, of \$10 per thousand board feet of lumber. Each additional incremental price increase or decrease of \$10 per thousand board feet of lumber sold is expected to have an impact on operating earnings of slightly less than \$7 million per increment due to the likely related change in stumpage fees.

Western's financial performance is also dependent on the rate at which production capacity is utilized. In times of challenging conditions in any of our major markets the Company maintains inventory control by aligning log supply and lumber production with anticipated sales volumes. When capacity utilization is reduced in response to weak demand for products, the cost per unit of production may increase and profitability decrease.

From time to time and in accordance with market influences, the Company will reduce production with temporary logging and/or sawmilling curtailments. In extreme cases, such curtailments may become permanent closures. When Western undertakes significant market-related curtailments of sawmills, the volume of chips produced is reduced and accordingly there is greater risk that the Company may not meet minimum contractual obligations under long-term chip supply agreements without incurring additional cost.

International Business and Risks of Exchange Rate Fluctuations

Western's products are sold in international markets. Economic conditions in those markets, the strength of the housing markets in the US and Japan, fluctuations in foreign exchange rates and international sensitivity to interest rates, can all have a significant effect on our financial condition and results of operations. In general, our sales are subject to the risks of international business, including:

- fluctuations in foreign currencies;
- changes in the economic strength of the countries in which we conduct business;
- trade disputes;
- changes in regulatory requirements;
- tariffs and other barriers;
- quotas, duties, taxes and other charges or restrictions upon exports or imports;
- transportation costs and the availability of carriers of any kind including those by land or sea; and
- strikes or labour disputes in the transportation industry or related dock or container service industries.

Depending on product mix, destination and exchange rates, between 35% and 45% of our total product sales are denominated in US dollars and between 10% and 15% in JPY, while most operating costs and expenses are incurred in Canadian dollars, with small portions in US dollars and JPY. The Company's functional currency is the Canadian dollar and financial results are reported in Canadian dollars. Significant variations in relative currency values, particularly significant changes in the value of the Canadian dollar relative to the US dollar, have had, and in the future could have, a material impact on our operating earnings and cash flows. We estimate that an increase or decrease of 1% in the value of the Canadian dollar compared to the US dollar and Japanese Yen would decrease or increase annual operating earnings by approximately \$4.5 million, and \$0.8 million, respectively.

The Softwood Lumber Agreement ("SLA") with the US was implemented on October 12, 2006. The agreement has a term of seven years, extendable for up to two years, and may be terminated after 18 months by either the Canadian or US government with not less than six months' notice. On January 23,

2012, Canada and the US agreed on a two year extension of the SLA, which will now terminate in October, 2015. We are unable to predict whether the agreement will be terminated prior to expiration or the consequences upon termination, should it occur. In addition, the agreement provides that if the monthly volume of exports from the British Columbia coastal region exceeds a certain “Trigger Volume” as defined in the agreement, a “surge” mechanism will apply to increase the rate of the export tax for that month by 50% (for example, a 15% export tax rate would become 22.5% for that month). The surge mechanism can be triggered by any or all companies in the region over-shipping, causing total exports to exceed the trigger volume. We are unable to predict if or when the surge mechanism will apply to any of our future lumber shipments into the US.

Employees and Labour Relations

Hourly paid employees at our manufacturing facilities, timber harvesting operations and a small group of clerical employees are unionized. Currently we negotiate and administer six collective agreements. Our unionized employees are represented by the United Steel Workers (“USW”) or the Pulp, Paper and Woodworkers of Canada (“PPWC”) or the Canadian Merchant Service Guild (“Guild”). The collective agreement covering the majority of Western’s unionized employees was renewed with the USW in 2010 and expires on June 14, 2014. Other collective agreements negotiated in 2010 include employees affiliated with the PPWC at the Company’s Ladysmith Sawmill Operation and Value Added Remanufacturing operation, South Island Remanufacturing operation and a Quatsino Dry Land Sort tug boat Captain who is affiliated with the Guild. These agreements expire on December 31, 2014, October 14, 2016, May 22, 2017 and September 30, 2015, respectively. A collective agreement covering USW clerical employees expired on December 31, 2013. The Company is currently in negotiations with USW over the renewal of the clerical employees’ collective agreement.

Should the Company be unable to negotiate an acceptable contract after any of these collective agreements expire with any of the unions, a strike or lockout could occur. A strike or lockout could involve significant disruption of operations and/or an adverse material impact on our financial condition. Furthermore, a negotiated settlement could result in unplanned increases in wages or benefits payable to unionized employees. In addition, the Company relies on certain third parties, such as logging contractors, stevedores or major railways, whose workforces are unionized, to provide the Company with services necessary to operate the business. If those workers/employers engage in a strike or lockout, our operations could be disrupted.

Long-Term Competition

The markets for our products are highly competitive on a domestic and international level, with a large number of major companies competing in each market, some of which have substantially greater financial resources than Western. We also compete indirectly with firms that manufacture substitutes for solid wood products, including non-wood and engineered wood products. While the principal basis for competition is price, we also compete to a lesser extent on the basis of quality and customer service. In addition, market acceptance of the environmental sustainability of our products as compared with substitutes could be a challenge in the future. Changes in the level of competition, industry capacity and the global economy have had, and are expected to continue to have, a significant impact on the selling prices of the Company’s products and the overall profitability of the Company. Our competitive position will be influenced by factors including the availability, quality and cost of fibre, energy and labour, and plant efficiencies and productivity in relation to our competitors. Our competitive position could be affected by fluctuations in the value of the Canadian dollar relative to the US dollar and/or the JPY, and by the export tax on softwood lumber shipments to the US.

Forest Resource Risk and Natural Catastrophes

Our timber tenures are subject to the risks associated with standing forests, in particular, forest fires, wind storms, insect infestations and disease. Procedures and controls are in place to try and mitigate such risk through prevention and early detection. Most of the timber that we harvest comes from Crown tenures and insurance coverage is maintained only for loss of logs following harvesting due to fire and other occurrences. However, this coverage does not extend to standing timber, and there is no assurance that this coverage would be adequate to provide protection against all eventualities, including natural catastrophes. Western has entered into a cost-sharing agreement with the Crown for our private

timberlands to reduce individual incident costs of mobilizing helicopters and aerial water tankers in the event of a fire on those lands.

In addition, our operations may be adversely affected by severe weather including wind, snow and rain that may result in our operations being unable to harvest or transport logs to our manufacturing facilities for extended periods of time. Although we anticipate and factor in a certain period of down-time due to weather, extended periods of severe or unusual weather may adversely impact our financial results due to higher costs and missed sales opportunities arising from fibre shortages or the deterioration of logs remaining on the ground or in the water for extended periods of time.

Other than two sales offices in Japan, all of our business operations are located on the BC coast, which is geologically active and considered to be at risk from earthquakes.

Climate change over time is predicted to lead to changes in the frequency of storm events as well as their severity. We also expect to see changes in the occurrence of wildfires and forest pest outbreaks. Long-term climatic models are predicting that the optimum ranges of many species, including those of our major tree species, will shift over time. We are unable to predict the impact of all of these factors on our tenures or on forest practices.

While the Company maintains insurance coverage to the extent deemed prudent by us, we cannot guarantee that all potential insurable risks have been foreseen or that adequate coverage is maintained against known risks.

Impact of Mountain Pine Beetle Infestation

The north-central interior forests of BC and western parts of Alberta have been, and continue to be, seriously damaged by North America's largest recorded mountain pine beetle infestation. Western does not operate in the affected area and lodgepole pine, the species most at risk from the infestation, is not a key source of timber in the coastal forests. This natural disaster is causing widespread mortality of lodgepole pine. There is growing evidence that, as the dead trees decay, they become more difficult and costly to manufacture into lumber and that the quality of the residual wood chips may diminish. There may also be access issues over time as developing second growth forests grow to a size that precludes efficient entry into remote pine beetle damaged stands.

The mountain pine beetle has crossed into Alberta, and timber harvesting of lodgepole and jackpine in Alberta may see an increase in Allowable Annual Cut ("AAC") to promote salvage before decay, potentially adding to downward price pressures as the lumber supply may increase. The Company is unable to predict when or if the mountain pine beetle infestation will be halted or its impact on future lumber, chip and log prices.

Pulp and Paper Market Variability

The selling price in Canadian dollars of our residual wood chips is tied by formula to published indices that reflect the US dollar selling price of NBSK pulp. Fluctuations in pulp prices and foreign currencies will accordingly impact the selling price of our residual wood chips. The price and demand for the pulp logs and other logs sold to pulp and paper companies is also dependent on the market conditions for pulp and paper. If there is a contraction in the coastal pulp and paper industry, we may need to find alternative customers for the pulp logs and residual chips from our sawmills.

Dependency on Fibre Obtained from Government Timber Tenures

Currently, substantially all of the timberlands in which we operate are owned by the Province and are currently administered by the Ministry of Forests, Lands and Natural Resource Operations (the "MFLNRO"). The *Forest Act* (British Columbia) (the "Forest Act") empowers the MFLNRO to grant timber tenures, including Tree Farm Licences ("TFLs"), Forest Licences ("FLs") and Timber Licences ("TLs"), to producers, although no new TLs can be issued and the availability of extensions to expiring TLs is not assured. The Provincial Chief Forester must conduct a review of the AAC for each Timber Supply Area and each TFL in the Province on a periodic basis, at least once every ten years. This review is then used to determine the AAC for licences issued by the Province under the Forest Act. Many factors affect the AAC such as timber inventory, the amount of operable forest land, growth estimates of young forests, regulation changes and environmental and social changes. Such assessments have in the past resulted

and may in the future result in reductions or increases to the AAC attributable to licences held by BC forest companies (without compensation), including the licences that we hold. In addition, our AAC can be temporarily reduced (without compensation for the first four years) in areas where logging has been suspended under Part 13 of the Forest Act pending further consideration in land use planning. Land use planning, including critical habitat designations as well as new harvesting regulations, can constrain access to timber and new parks can permanently remove land from the timber harvesting land base. There can be no assurance that the amounts of such future reductions on our licences, if any, will not be material or the amounts of compensation, if any, for such reductions will be fair and adequate.

Forest Policy Changes in British Columbia

There have been significant legislative reforms in the BC Forest Industry over the last 40 years. One of the more significant examples of this was seen in 2003 when the Province took back approximately 20% of the AAC from major license holders, including Western, and provided monetary compensation in return. There can be no assurance that the Province will not implement further policy changes, or that such changes will not have a material adverse effect on our operations or our financial position.

First Nations Land Claims

First Nations groups have made claims of rights and title to substantial portions of land in British Columbia, including areas where our timber tenures and operations are situated, creating uncertainty as to the status of competing property rights and of legislation and Crown decisions that adversely affect such asserted rights and title. The Supreme Court of Canada has held that aboriginal groups may have a spectrum of constitutionally recognized and affirmed aboriginal rights and title in lands that have been traditionally used or occupied by their ancestors; however, such rights or title are not absolute and may be infringed by government in furtherance of a valid legislative objective, including forestry, subject to meeting a justification test. The effect on any particular lands will not be determinable until the nature of historical use, occupancy and rights in any particular piece of property have been clarified. The Supreme Court of Canada has also held that even before claims of rights and title are proven, the Crown has a legal duty to consult with First Nations, which can become a duty to seek possible accommodations, when the Crown has knowledge, real or constructive, of the potential existence of an aboriginal right or title and contemplates conduct that might adversely impact it. During the period before asserted claims are proven, the Crown is required to consult in good faith with the intention of substantially addressing First Nation concerns, but First Nations agreement is not required in these consultations.

First Nations are seeking compensation from governments (and in some instances from forest tenure holders) with respect to these claims, and the effect of these claims on timber tenure rights, including our timber tenures, cannot be estimated at this time. The Federal and Provincial Governments have been seeking to negotiate treaty settlements with aboriginal groups in British Columbia in order to resolve these claims. On April 1, 2011, the first modern treaty affecting the Company's tenures was brought into force. The Maa'nulth Treaty extinguished the Company's tenure rights on Maa'nulth Treaty Settlement lands within TFL 44 and permanently reduced the tenure's AAC by 95,200 cubic metres. A treaty measure which created a new Protected Area inside of TFL 44 permanently reduced the AAC by another 8,800 cubic metres. The Company is in discussions with the Province on the magnitude of the treaty impacts on AAC, improvements, soft cost investments and downstream business. As these discussions are ongoing, any settlement or the amounts of compensation that we would receive for this or future reductions of our tenures as a result of this process cannot be estimated at this time and none has been recorded as a receivable. Other treaty processes involving the Nam'gis, Sliammon, Ditidaht, K'omox and Wuikinuxv First Nations are also well advanced and may lead to agreements impacting Western in 2014. It is expected that through these and other treaty-related processes the Provincial Government will want to remove areas out of the Company's various forest tenures.

Current Provincial Government policy requires that forest management and operating plans take into account and not unreasonably infringe on aboriginal rights and title, proven or unproven, and provide for consultation with First Nations. This policy is reflected in the terms of our timber tenures, which provide that the MFLNRO may vary or refuse to issue cutting permits in respect of a timber tenure if it is determined by a court that the forestry operation would unreasonably interfere with aboriginal rights or title. First Nations have, at times, sought to restrict the Provincial Government from granting or replacing forest tenures and other operating authorizations or from approving forest management plans on Crown

lands without full consultation and accommodation or their consent if these decisions could affect lands claimed by them. There can be no assurance that denial of required approvals for, or changes to the terms of our timber tenures, other operating authorizations or forest management plans as a consequence of such consultation or action will not have an adverse effect on our financial condition or results of operations.

An unfavourable result in any of the First Nations litigation in which the Company is a party or which involves assets of the Company could have a material adverse effect on our financial condition or results of operations. See also "*Legal Proceedings*".

Stumpage Fees

Stumpage is the fee that the Province charges forest companies for timber harvested from Crown land in BC. More than 95% of the timber we harvest is from Crown land. In response to US Softwood Lumber dispute, the Provincial Government adopted a new market pricing system for timber from the Coastal region. Since February 29, 2004, stumpage is being set using the Coast version of the Market Pricing System ("MPS"). MPS uses the winning bids and stand characteristics of timber sold through British Columbia Timber Sales ("BCTS") auctions to develop regression equations that predict the market (i.e. auction) value of Crown timber harvested under long-term tenures. The auction value is then adjusted to reflect costs that tenure holders incur that BCTS expends on behalf of bidders. These costs, like forest planning and administration and silviculture, are referred to as Tenure Obligation Adjustments. Coastal MPS is updated on a routine basis to reflect recent sales data and costs. The most recent update occurred on January 1, 2014. Stumpage rates are also adjusted quarterly to reflect changes in log prices.

There can be no assurance that future changes to the stumpage system or the Province's administrative policy will not have a material impact on the stumpage fees payable by us and consequently affect our financial condition and results of operations.

Long-term Fibre Supply Agreements

The Company has a number of long-term commitments to supply chip fibre, saw logs and pulp logs to third parties. Certain of these fibre supply agreements have minimum volume requirements. A failure to supply the minimum volumes may result in additional costs or deferred obligations. In one case the failure to supply the minimum volume could result in the loss of a TFL, but with a concurrent reduction in the future fibre supply commitment under that agreement.

Safety

The Company's safety policy reflects its values and commitment to providing a healthy and safe workplace for its people, while at the same time ensuring compliance with our regulatory requirements under WorkSafeBC. Workplace safety laws and regulations change over time and may involve new methodologies and additional costs necessary to bring the Company into compliance.

Environmental Regulation

We are subject to extensive federal and provincial environmental laws and regulations. These laws and regulations impose stringent standards on our operations and impose liability to remedy problems for which we are legally responsible regarding, among other things:

- air emissions;
- land and water discharges;
- operations or activities affecting watercourses or the natural environment;
- operations or activities affecting species at risk;
- use and handling of hazardous materials;
- use, handling, and disposal of waste; and
- remediation of environmental contamination.

We may incur substantial costs to comply with current or future requirements, to respond to orders or directions made, to remedy or to compensate others for the cost to remedy problems for which we are legally responsible or to comply with new environmental laws that may be adopted from time to time. In addition, we may discover currently unknown environmental problems or conditions affecting our operations or activities or for which we are otherwise legally responsible. Western has closed certain operations and although we have engaged specialists to advise us of environmental problems and conditions, normal site clean-up may identify additional problems or conditions. Any such event could have a material adverse effect on our financial condition and results of operations.

Western is one of five founding members of the Coast Forest Conservation Initiative (the "CFCI"). CFCI is a collaborative effort amongst forest companies working in BC's Central and North Coast. Its purpose is to define and support the development of an ecosystem-based management ("EBM") as part of 2003 Land and Resource Management Plan recommendations. In March 2006, interim legal objectives for EBM were enacted. These objectives were further amended in March 2009 with final implementation deferred for 5 years while the concept, intended to be unique to this region, was fully defined. The CFCI Companies, along with major environmental groups have delivered a suite of recommendations for consideration by the Province and the 27 First Nations who live in the region. How final resolution of EBM will impact Western's timber supply is not known at this time. Further amendment of legal objectives is expected to take place in 2014.

Regulatory Risks

Our forestry and sawmill operations are subject to extensive federal, provincial, municipal and other local laws and regulations, including those governing forestry, exports, taxes, labour standards, occupational health, safety, waste disposal, building structures/systems, environmental protection and remediation, protection of endangered and protected species and land use and expropriation. Under certain laws and regulations, we are also required to obtain permits, licences and other authorizations to conduct our operations, which permits, licences and authorizations may impose additional conditions that must be satisfied. Although we budget for expenditures to maintain compliance with such laws and permits, there can be no assurance that these laws and regulations or government policy will not change in the future in a manner that could have an adverse effect on our financial condition or results of operations or the manner in which we operate. Nor can there be any assurance that administrative interpretation of existing laws and regulation will not change or more stringent enforcement of existing laws will not occur, in response to changes in the political or social environment in which we operate or otherwise, in a manner that could have an adverse effect on our financial condition or results of operations or the manner in which we operate.

Log exports from our timber operations are subject to federal and provincial regulations. An export permit from the Canadian Federal government must be obtained to export any logs harvested in BC and generally the logs must be surplus to the supply required for domestic manufacturers. Logs from private timberlands which were granted by the Crown prior to March 12, 1906 are subject to the Federal surplus test and logs from private land granted after that date are subject to the Provincial surplus test. Logs harvested from Crown land in BC are subject to the Provincial surplus test. The regulations also restrict the species and grade permitted for export.

Under both the federal and provincial surplus tests, the logs must be advertised for local consumption. Logs are declared surplus and may be exported if there are no offers on the advertised logs by domestic manufacturers. In practice, domestic offers on export volume can be satisfied with replacement volume to minimize operational impacts. However, a substantial increase in domestic demand may adversely impact timber operations as export pricing is generally at a premium to domestic pricing. In July 2013, the Ehattesaht First Nation filed a petition with the BC Supreme Court against the Province of British Columbia regarding a decision of the Crown on the amount of un-harvested volume in TFL 19 from the 2007 to 2011 cut control period, which may subsequently be directly awarded to the Ehattesaht. The Ehattesaht claim the Crown did not adequately consult them about the decision and that additional volume must be made available to them based upon their asserted territory, rights, and economic interests. The Company has joined the proceedings as a party respondent as any decisions regarding the disposition of un-harvested volume arising from cut control performance directly impacts our interest within the TFL. A court date is tentatively set for February 2014.

In January 2008, the Ditidaht First Nation commenced litigation in the BC Supreme Court against the Province of British Columbia, Canada, certain other First Nations and two forestry companies, including Western, seeking amongst other things declarations of aboriginal title and rights in areas of Vancouver Island that include areas covered by timber tenures held by the Company and declarations that provincial forestry legislation and the Company's timber tenures are of no force or effect on the claimed aboriginal title lands. In March 2013, the Ditidaht and BC Government entered an Interim Treaty Agreement (the "ITA") which included Ditidaht agreement not to initiate or proceed with litigation against the Crown for land dispositions and land use authorizations during the term of the ITA. Consequently, unless the ITA is terminated in accordance with the provisions for termination in the ITA, this litigation will not be pursued further by Ditidaht.

In April 2008, the Kwakiutl First Nation commenced litigation in the BC Supreme Court against the Province of British Columbia, Western and the federal government seeking, amongst other things, orders to set aside the Province's decision to remove Western's private lands from a TFL and the Province's approval of the Company's Forest Stewardship Plan ("FSP") on the Crown lands within their area of interest, based on alleged infringements of their treaty rights and extinguished aboriginal title and rights. This case was decided in June 2013, with the court upholding the Private Land withdrawal from TFL 6 and also the decision to extend the term of our FSP. The Crown was found to have an ongoing duty to consult the Kwakiutl in good faith and to seek accommodations regarding their claim of extinguished Aboriginal rights, titles and interests in respect of the Kwakiutl traditional territory. The Crown has subsequently filed an appeal of the decision pertaining to their ongoing duty to consult with the Kwakiutl.

In 2005, the Hupacasath First Nation obtained an order of the BC Supreme Court requiring the Province of BC to consult with them regarding certain Crown decisions, including a 2004 decision of the Minister of Forests, Mines and Lands to remove private lands from TFL 44, a TFL subsequently acquired by the Company. In 2008, the Court ordered that a mediator be appointed to address appropriate accommodation for the effects of the Minister's 2004 private land decision upon the asserted aboriginal rights of the Hupacasath First Nation on their claimed territory, both with respect to the private lands that are now outside the TFL and the Crown lands that remain within the Company's TFL. In July 2012, the Hupacasath and BC Government executed a mediated agreement which included the following accommodations within TFL 44 as a result of the 2004 decision to remove private land from TFL 44: a Government Action Regulation Order for protection of a spiritual area at Thunder Mountain, 400 hectares of new Old Growth Management Areas around Great Central Lake, a 20,000 cubic metre non replaceable forest licence in the vicinity of Great Central Lake and a First Nations Woodland Licence also at Great Central Lake as per the previous *Forestry Revitalization Act* timber volume allocation to the Hupacasath.

The Company is currently unable to predict the outcome of these First Nation legal proceedings on Western's ongoing operations or on any sale of its non-core assets and private forestry lands.

In addition, Western is subject to routine litigation incidental to our business, the outcome of which we do not anticipate will have a materially adverse effect on our financial condition and results of operations.

Reliance on Directors, Management and Other Key Personnel

Western relies upon the experience and expertise of our personnel. No assurance can be given that we will be able to retain our current personnel and attract additional personnel as necessary for the development and operation of our business. Loss of or failure to attract and retain key personnel could have a material adverse effect on Western's business.

Change of Control of Western

If a change of control, defined as an acquisition of greater than 50% of the outstanding Voting Shares, of Western were to occur, there could be significant adverse consequences to Western. If it is determined that there has been an acquisition of control for Canadian tax purposes we may lose the benefit of historical tax losses, which may limit our ability to shelter future operating income from tax. In addition, if the MFLNRO were to be satisfied that any change or acquisition of control unduly restricted competition in standing timber, log or wood chip markets, the Minister could make a determination to cancel all or a part of our Forest Act tenures. If this were to occur, we may have to obtain the fibre to run the combined business facilities from external sources, perhaps at a higher cost. A significant increase in our costs

could have a material adverse effect on the financial condition and results of operations of the combined business.

Certain Voting Rights of the Non-Voting Shares

The holders of Non-Voting Shares are generally not entitled to vote at meetings of our shareholders. They are, however, entitled to one vote per share on any vote relating to our liquidation, dissolution or winding-up, or the sale, lease or exchange of all or substantially all of our property and as otherwise provided by law or any amendment that would add, change or remove attributes of the Non-Voting Shares or any class of share adversely affecting the Non-Voting Shares either separately or in relation to the Common Shares. As such, holders of Non-Voting Shares will be able to vote on, and potentially affect the outcome of, certain transactions, such as our liquidation or winding-up or the sale of substantially all of our assets.

As of the date of this report there were no Non-Voting Shares issued and outstanding.

Evaluation of Disclosure Controls and Procedures

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, Western conducted an evaluation of the effectiveness of the disclosure controls and procedures and the system of internal control over financial reporting based on the 1992 framework: "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's system of internal control over financial reporting was effective as at December 31, 2013. The evaluation was carried out under the supervision and with the participation of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on the evaluation, Western's CEO and CFO concluded that the Company's disclosure controls and procedures are effective in providing reasonable assurance that material information relating to Western and its consolidated subsidiaries is made known to them by others within those entities, particularly during the period in which the annual filings are being prepared. In addition, Western's CEO and CFO concluded that the Company's internal controls over financial reporting are effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for Western and its consolidated subsidiaries for the period in which the annual filings are being prepared.

The CEO and CFO confirm that there were no changes in the controls which materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting during the last quarter of 2013.

Outstanding Share Data

As of February 20, 2014, there were 391,128,407 Common Shares issued and outstanding. BSSML controls and directs 40.1% of the Company's Common Shares. There were no Non-Voting Shares issued and outstanding at February 20, 2014.

Western has reserved 20,000,000 Common Shares for issuance upon the exercise of options granted under the Company's incentive stock option plan. During 2013, 3,500,000 options were granted. As of February 20, 2014, 13,016,795 options were outstanding under the Company's incentive stock option plan.

Management's Discussion and Analysis – Appendix A

Summary of Selected Results for the Last Eight Quarters

(millions of dollars except per share amounts and where noted)

	2013					2012				
	Year	4 th	3 rd	2 nd	1 st	Year	4 th	3 rd	2 nd	1 st
Average Exchange Rate – Cdn \$ to purchase one US \$	1.030	1.049	1.039	1.023	1.008	1.000	0.991	0.996	1.010	1.001
Revenues										
Lumber	677.2	168.1	171.7	180.4	157.0	624.4	156.1	147.3	163.8	157.2
Logs	243.8	59.7	53.9	67.0	63.2	246.3	62.9	58.5	73.0	51.9
By-products	56.5	14.2	13.8	14.9	13.6	54.7	12.2	13.6	14.6	14.3
Total revenues	977.5	242.0	239.4	262.3	233.8	925.4	231.2	219.4	251.4	223.4
Lumber										
Shipments – millions of board feet	895	222	228	231	214	894	222	218	234	220
Price – per thousand board feet	757	758	752	782	733	699	703	676	700	716
Logs										
Shipments – thousands of cubic metres	2,769	697	615	765	692	3,430	835	876	1,020	699
Price – per cubic metre ⁽¹⁾	85	84	83	84	89	70	73	65	69	72
Selling and administration ⁽²⁾	33.0	8.8	8.2	8.0	8.0	28.6	6.8	6.8	7.3	7.7
Adjusted EBITDA ⁽²⁾	128.8	24.4	27.6	44.9	31.9	51.0	14.3	8.5	18.8	9.4
Amortization	(29.2)	(7.0)	(7.5)	(7.9)	(6.8)	(25.8)	(5.9)	(6.2)	(6.9)	(6.8)
Changes in fair value of biological assets	(2.3)	(0.7)	(0.3)	(0.8)	(0.5)	(0.4)	(0.3)	0.4	(0.4)	(0.1)
Reversal of impairment	8.2	8.2	-	-	-	12.9	12.9	-	-	-
Operating restructuring items	(0.7)	(0.1)	(0.3)	(0.1)	(0.2)	(4.8)	(4.2)	(0.2)	(0.4)	-
Finance costs ⁽²⁾	(5.4)	(1.7)	(1.7)	(0.8)	(1.2)	(6.3)	(1.4)	(1.4)	(1.9)	(1.6)
Other income (expenses)	0.3	(0.1)	(0.4)	0.7	0.1	2.8	(0.9)	1.1	1.6	1.0
Deferred income tax recovery	26.5	26.5	-	-	-	-	-	-	-	-
Current income tax recovery (expense)	(0.3)	0.4	(0.2)	(0.3)	(0.2)	(0.1)	-	(0.1)	-	-
Net income from continuing operations ⁽²⁾	125.9	49.9	17.2	35.7	23.1	29.3	14.5	2.1	10.8	1.9
Net loss from discontinued operations	(0.5)	-	-	(0.2)	(0.3)	(1.1)	(0.2)	(0.3)	(0.4)	(0.2)
Net income ⁽²⁾	125.4	49.9	17.2	35.5	22.8	28.2	14.3	1.8	10.4	1.7
Adjusted EBITDA as % of revenues	13.2%	10.1%	11.5%	17.1%	13.6%	5.5%	6.2%	3.9%	7.5%	4.2%
Earnings per share:										
Net income, basic	0.29	0.13	0.04	0.08	0.05	0.06	0.03	-	0.02	-
Net income, diluted	0.28	0.13	0.04	0.07	0.05	0.06	0.03	-	0.02	-
Net income from continuing operations, basic	0.29	0.13	0.04	0.08	0.05	0.06	0.03	-	0.02	-
Net income from continuing operations, diluted	0.28	0.13	0.04	0.07	0.05	0.06	0.03	-	0.02	-

⁽¹⁾ The log revenue used to determine average price per cubic metre has been reduced by the associated shipping costs arranged in the respective periods to enable comparability of unit prices.

⁽²⁾ Adjusted EBITDA, Selling and administration expenses, Finance costs, Net income from continuing operations and Net income have been restated to reflect the adoption of changes to IAS 19 - *Employee Benefits* as described commencing on Page 15 of the MD&A.

In a normal operating year there is seasonality to the Company's operations with higher lumber sales in the second and third quarters when construction activity, particularly in the US, has historically tended to be higher. Logging activity may also vary depending on weather conditions such as rain, snow and ice in the winter and the threat of forest fires in the summer.

The category of "Other income (expenses)" comprises net gains on the sale of various assets and other receipts which can be unpredictable in their timing. The fourth quarters of 2013 and 2012 include reversals of an impairment of \$8.2 million and \$12.9 million, respectively that had previously been taken on the Company's timber licenses (intangible assets) which were unusual adjustments. The fourth quarter of 2012 included a more significant charge for restructuring as a result of Western incurring a cost of \$4.0 million to reorganize harvesting operations in TFL 44 in order to improve operating performance in the future. In the fourth quarter of 2013 Western recognized a deferred income tax asset of \$26.5 million with respect to unutilized operating tax losses as described earlier (see *Income taxes* under the *Operating Results* section).

Western Forest Products Inc.
Consolidated Financial Statements

Years ended December 31, 2013 and 2012



Western Forest Products Inc.
CONSOLIDATED FINANCIAL STATEMENTS
MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The Management of Western Forest Products Inc. ("Western" or the "Company") is responsible for the accompanying Consolidated Financial Statements and all other information in the Management's Discussion and Analysis. The Consolidated Financial Statements have been prepared by Management in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and, where necessary, reflect Management's best estimates and judgments at this time. The financial information presented throughout the Management's Discussion and Analysis dated February 20, 2014 is consistent with that contained in the Consolidated Financial Statements.

Western maintains systems of internal accounting controls, policies and procedures to provide reasonable assurances as to the reliability of the financial records and the safeguarding of its assets. Management meets the objectives of internal accounting control on a cost-effective basis through the prudent selection and training of personnel, adoption and communication of appropriate policies, and employment of an internal audit program.

The Board of Directors reviews through oversight Management's responsibilities with respect to the Consolidated Financial Statements primarily through the activities of its Audit Committee, which is composed solely of independent directors of the Company. This Committee meets with Management and the Company's independent auditors KPMG LLP to review the Consolidated Financial Statements and recommend their approval by the Board of Directors. The Audit Committee is also responsible for making recommendations with respect to the appointment, remuneration and the terms of engagement of the Company's auditors. The Audit Committee also meets with the auditors, without the presence of Management, to discuss the results of the audit, related findings and their suggestions.

The Consolidated Financial Statements have been audited by KPMG LLP, who were appointed by the shareholders at the annual shareholders' meeting. The auditors' report follows.

A handwritten signature in black ink, appearing to read 'Don Demens', written over a horizontal line.

Don Demens
President and Chief Executive Officer

A handwritten signature in black ink, appearing to read 'Brian Cairo', written over a horizontal line.

Brian Cairo
Chief Financial Officer

February 20, 2014



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Canada

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Western Forest Products Inc.

We have audited the accompanying consolidated financial statements of Western Forest Products Inc., which comprise the consolidated statements of financial position as at December 31, 2013 and December 31, 2012, the consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Western Forest Products Inc. as at December 31, 2013 and December 31, 2012, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

February 20, 2014
Vancouver, Canada

Western Forest Products Inc.
Consolidated Statements of Financial Position
(Expressed in millions of Canadian dollars)

	December 31, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 5.6	\$ 18.8
Trade and other receivables	69.0	69.5
Inventory ^(Note 4)	132.5	116.6
Prepaid expenses and other assets	10.1	7.6
	<u>217.2</u>	<u>212.5</u>
Non-current assets:		
Property, plant and equipment ^(Note 5)	226.0	194.2
Intangible assets ^(Note 5)	130.5	126.1
Biological assets ^(Note 6)	58.4	60.8
Other assets ^(Note 7)	11.9	12.7
Deferred income tax assets ^(Note 10)	26.5	-
	<u>\$ 670.5</u>	<u>\$ 606.3</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 79.8	\$ 74.0
Silviculture provision ^(Note 12)	12.3	13.4
Discontinued operations ^(Note 22)	0.6	5.1
	<u>92.7</u>	<u>92.5</u>
Non-current liabilities:		
Long-term debt ^(Note 9)	88.5	33.8
Silviculture provision ^(Note 12)	17.7	17.6
Other liabilities ^(Note 11)	20.3	35.6
Deferred revenue	64.4	66.4
Discontinued operations ^(Note 22)	4.5	2.7
	<u>288.1</u>	<u>248.6</u>
Shareholders' equity:		
Share capital - voting shares ^(Note 13)	486.6	479.7
Share capital - non-voting shares ^(Note 13)	13.1	120.3
Contributed surplus	6.5	4.2
Revaluation reserve	22.3	22.3
Deficit	(146.1)	(268.8)
	<u>382.4</u>	<u>357.7</u>
	<u>\$ 670.5</u>	<u>\$ 606.3</u>

Commitments and Contingencies ^(Note 15) and Subsequent Event ^(Note 25)

See accompanying notes to these consolidated financial statements

Approved on behalf of the Board:



Dominic Gammiero, Chairman



Lee Doney, Vice Chairman

Western Forest Products Inc.
Consolidated Statements of Comprehensive Income

(Expressed in millions of Canadian dollars except for share and per share amounts)

	Year ended	
	December 31,	
	2013	2012
		[Restated - Note 17]
Revenue	\$ 977.5	\$ 925.4
Cost and expenses:		
Cost of goods sold	764.3	777.8
Export tax	0.9	6.0
Freight	82.0	88.2
Selling and administration	33.0	28.6
Reversal of impairments ^(Note 5)	(8.2)	(12.9)
	<u>872.0</u>	<u>887.7</u>
Operating income prior to restructuring items and other income	<u>105.5</u>	<u>37.7</u>
Operating restructuring items ^(Note 19)	(0.7)	(4.8)
Other income ^(Note 21)	0.3	2.8
	<u>105.1</u>	<u>35.7</u>
Operating income	<u>105.1</u>	<u>35.7</u>
Finance costs ^(Note 20)	(5.4)	(6.3)
Income before income taxes	99.7	29.4
Deferred income tax recovery ^(Note 10)	26.5	-
Current income tax expense ^(Note 10)	(0.3)	(0.1)
	<u>125.9</u>	<u>29.3</u>
Net income from continuing operations	125.9	29.3
Net loss from discontinued operations ^(Note 22)	(0.5)	(1.1)
	<u>125.4</u>	<u>28.2</u>
Net income for the period	<u>125.4</u>	<u>28.2</u>
Other comprehensive income		
Items that will not be reclassified to profit or loss:		
Change in revaluation reserve	-	(1.6)
Defined benefit plan actuarial gain (loss)	12.9	(7.0)
	<u>12.9</u>	<u>(7.0)</u>
Total comprehensive income for the period	<u>\$ 138.3</u>	<u>\$ 19.6</u>
Net income per share (in dollars):		
Basic earnings per share	\$ 0.29	\$ 0.06
Diluted earnings per share	\$ 0.28	\$ 0.06
Basic earnings per share - continuing operations	\$ 0.29	\$ 0.06
Diluted earnings per share - continuing operations	<u>\$ 0.28</u>	<u>\$ 0.06</u>
Weighted average number of shares outstanding (thousands)		
Basic	438,547	467,945
Diluted	443,254	470,459

See accompanying notes to these consolidated financial statements

Western Forest Products Inc.
Consolidated Statements of Changes in Shareholders' Equity

(Expressed in millions of Canadian dollars)

	Share Capital	Contributed Surplus	Revaluation Reserve	Deficit [Restated - Note 17]	Total equity
Balance at December 31, 2011	\$ 599.8	\$ 3.4	\$ 23.9	\$ (290.0)	\$ 337.1
Net income	-	-	-	28.2	28.2
Other comprehensive loss:					
Change in revaluation reserve	-	-	(1.6)	-	(1.6)
Defined benefit plan actuarial loss recognized	-	-	-	(7.0)	(7.0)
Total comprehensive income	-	-	(1.6)	21.2	19.6
Share-based payment transactions recognized in equity	-	0.9	-	-	0.9
Exercise of stock options	0.2	(0.1)	-	-	0.1
Total transactions with owners, recorded directly in equity	0.2	0.8	-	-	1.0
Balance at December 31, 2012	\$ 600.0	\$ 4.2	\$ 22.3	\$ (268.8)	\$ 357.7
Balance at December 31, 2012	\$ 600.0	\$ 4.2	\$ 22.3	\$ (268.8)	\$ 357.7
Net income	-	-	-	125.4	125.4
Other comprehensive income:					
Defined benefit plan actuarial gain recognized	-	-	-	12.9	12.9
Total comprehensive income	-	-	-	138.3	138.3
Share-based payment transactions recognized in equity	-	2.3	-	-	2.3
Repurchase of shares ^(Note 13)	(100.3)	-	-	-	(100.3)
Dividends	-	-	-	(15.6)	(15.6)
Total transactions with owners, recorded directly in equity	(100.3)	2.3	-	(15.6)	(113.6)
Balance at December 31, 2013	\$ 499.7	\$ 6.5	\$ 22.3	\$ (146.1)	\$ 382.4

See accompanying notes to these consolidated financial statements

Western Forest Products Inc.
Consolidated Statements of Cash Flows
(Expressed in millions of Canadian dollars)

	Year ended December 31,	
	2013	2012 [Restated - Note 17]
Cash provided by (used in):		
Operating activities:		
Net income from continuing operations	\$ 125.9	\$ 29.3
Items not involving cash:		
Amortization of property, plant and equipment ^(Note 5)	25.5	22.4
Amortization of intangible assets ^(Note 5)	3.7	3.4
Loss (gain) on disposal of assets	(1.5)	(1.7)
Change in fair value of biological assets ^(Note 6)	2.3	1.6
Net finance costs	5.4	6.3
Reversal of impairments on intangible assets ^(Note 5)	(8.2)	(12.9)
Deferred income tax recovery ^(Note 10)	(26.5)	-
Other	(2.7)	(6.4)
	<u>123.9</u>	<u>42.0</u>
Changes in non-cash working capital items:		
Trade and other receivables	0.5	(6.6)
Inventory	(15.9)	16.0
Prepaid expenses and other assets	(2.5)	(1.1)
Silviculture provision	(1.1)	0.1
Accounts payable and accrued liabilities	5.8	7.3
	<u>(13.2)</u>	<u>15.7</u>
	<u>110.7</u>	<u>57.7</u>
Investing activities:		
Additions to property, plant and equipment ^(Note 5)	(59.0)	(32.0)
Proceeds on disposals of assets	3.3	16.9
	<u>(55.7)</u>	<u>(15.1)</u>
Financing activities:		
Changes in revolving credit facility	-	(8.9)
Interest paid	(3.5)	(4.0)
Repayment of long-term debt	(45.0)	(28.0)
Draw down of long-term debt	100.0	3.7
Refinancing fees	(0.6)	(1.0)
Repurchase of shares ^(Note 13)	(100.3)	-
Dividends	(15.6)	-
Proceeds from exercise of stock options	-	0.2
	<u>(65.0)</u>	<u>(38.0)</u>
Cash provided by (used in) continuing operations	(10.0)	4.6
Cash used in discontinued operations ^(Note 22)	(3.2)	(1.1)
Increase (decrease) in cash and cash equivalents	(13.2)	3.5
Cash and cash equivalents, beginning of year	18.8	15.3
Cash and cash equivalents, end of year	<u>\$ 5.6</u>	<u>\$ 18.8</u>

See accompanying notes to these consolidated financial statements

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2013 and 2012

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

1. Reporting entity

Western Forest Products Inc. ("Western" or the "Company") is a major integrated softwood forest products company, incorporated and domiciled in Canada, operating in the coastal region of British Columbia. The address of the Company's registered office is Suite 510 – 700 West Georgia Street, Vancouver, British Columbia, Canada. The consolidated financial statements as at and for the years ended December 31, 2013 and 2012 comprise the Company and its subsidiaries. The Company's primary business includes timber harvesting, reforestation, forest management, sawmilling logs into lumber, wood chips, and value-added lumber remanufacturing. Western's lumber products are currently sold in over 30 countries worldwide. The Company is listed on the Toronto Stock Exchange, under the symbol WEF.

2. Basis of preparation

(a) Statement of compliance

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), as issued by the International Accounting Standards Board. Certain comparative figures have been reclassified to conform with the current year's presentation. The consolidated financial statements are available on www.sedar.com. The consolidated financial statements were authorized for issue by the Board of Directors on February 20, 2014.

(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following material items in the statement of financial position:

- Biological assets are measured at fair value less costs to sell;
- Land within property, plant and equipment is measured at fair value;
- Liabilities for cash-settled share-based payment transactions are measured at fair value at each reporting period;
- Equity-settled share-based payments are measured at fair value at grant date;
- Derivative financial instruments are measured at fair value;
- The defined benefit pension liability is recognized as the net total of the plan assets, less the present value of the defined benefit obligation; and
- Reforestation obligations are measured at the discounted value of expected future cash flows

(c) Functional and presentation currency

These consolidated financial statements are presented in the Canadian dollar which is the Company's functional currency. All amounts are presented in millions of Canadian dollars, unless otherwise indicated.

(d) Use of estimates and judgements

The preparation of the consolidated financial statements in conformity with IFRSs requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

(i) Judgements

Information about judgements made in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are included within the following note:

Note 5 – determination of appropriate cash generating units

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2013 and 2012

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

(ii) Assumptions and estimation uncertainties

Information about assumption and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year is included in the following notes:

Note 4 – measurement of net realizable value of inventories

Note 5 – measurement of the fair value of land, key assumptions used in discounted cash flows

Note 6 – measurement of fair value less costs to sell of standing timber

Note 10 – recognition of deferred income tax assets: availability of future taxable profit against which carry forward tax losses can be used

Notes 12 and 15 – recognition and measurement of provisions and contingencies: key assumptions about the likelihood and magnitude of an outflow of resources

Note 13 – measurement of share-based payment transactions

Note 17 – measurement of defined benefit obligations, key actuarial assumptions

Note 18 – measurement of foreign exchange forward contract derivatives

Measurement of fair values – a number of Western's accounting policies and disclosures require the measurement of fair values for both financial and non-financial assets and liabilities. An established framework is in place with respect to the measurement of fair values, including Level 3 fair values. Significant unobservable inputs and valuation adjustments are reviewed regularly. If third party information is used to measure fair values, Management assesses the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations would be classified.

When measuring the fair value of an asset or liability, Western uses market observable data as far as is possible. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- *Level 1*: quoted prices (unadjusted) in active markets for identical assets or liabilities
- *Level 2*: inputs other than quoted prices included in Level 1 that are observable for the assets or liability, either directly or indirectly
- *Level 3*: inputs for the asset or liability that are not based on observable market data

If the inputs to measure the fair value of the asset or liability might be categorized in different levels of the fair value hierarchy, then the fair value measurement is categorized in its entirety in the same level of the hierarchy as the lowest level input that is significant to the entire measurement. Transfers between levels of the fair value hierarchy are recognized at the end of the period in which the change occurred.

3. Significant accounting policies

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by Western. Western controls an entity when it is exposed to, or has rights to, variable returns from its investment with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which it ceases.

The principal wholly-owned operating subsidiaries of the Company at December 31, 2013 are Western Lumber Sales Limited (which sells into the United States), Western Forest Products Japan Ltd. (which sells into Japan), and WFP Quatsino Navigation Limited (the beneficial owner of a number of the Company's non-core assets).

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2013 and 2012

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

(ii) *Interests in equity-accounted investees*

Western's interests in equity-accounted investees comprise interests in joint ventures. A joint venture is an arrangement in which Western has joint control, whereby it has the rights to the nets assets of the arrangement, rather than rights to its assets and obligations for its liabilities.

Interests in the joint venture are accounted for using the equity method. They are recognized initially at cost, including transaction costs. Subsequent to initial recognition, the consolidated financial statements include Western's share of the profit and loss and OCI of equity accounted investees, until the date on which significant influence or joint control ceases.

(i) *Transactions eliminated on consolidation*

Inter-company balances and transaction, and any unrealized income and expenses arising from inter-company transactions, are eliminated. Unrealized gains arising from transactions with equity accounted investees are eliminated against the investment to the extent that Western's interest in the investee. Unrealized losses are eliminated in the same way, except to the extent that there is evidence of impairment.

(ii) *Discontinued operations*

A discontinued operation is a component of Western's business, the operations and cash flows of which can be clearly distinguished from the rest of Western and which:

- Represents a separate major line of business or geographical area of operations;
- Is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or
- Is a subsidiary acquired exclusively with a view to re-sale.

Classification as a discontinued operation occurs at the earlier of disposal or when the operation meets the criteria to be classified as held for sale.

(b) *New accounting policies*

(i) *Changes in accounting policies*

Western has adopted the following new standards and amendments to standards, including any consequential amendments to other standards with a date of initial application of January 1, 2013:

- Amendments to IAS 19, *Employee Benefits*

The Company has adopted the amendments to IAS 19 Employee Benefits effective January 1, 2013, with retrospective application. The amendments to IAS 19 require any remeasurement gains or losses, including actuarial gains and losses to be recognized immediately and presented in other comprehensive income (loss), eliminating the option to recognize these amounts through net income (loss).

The amendments to IAS 19 also require one discount rate be applied to the net defined benefit asset or liability for the purposes of determining the interest element of the defined benefit cost and require the recognition of unvested past service cost awards into earnings immediately. Under IAS 19, Western determines the net interest expense (income) on the defined benefit liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability at the beginning of the annual period, taking into account any changes to the net defined liability during the period as a result of contributions and benefit payments. Consequently, the net interest on the net defined benefit liability, now recognized in finance costs, comprises:

- interest cost on the defined benefit obligation; and
- interest income on plan assets.

Previously, the Company determined interest income on the plan assets based on their long term expected rate of return, and recognized the net interest cost in net income

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2013 and 2012

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through selling and administration expenses. The quantitative impact of the change is described in Note 17.

- IFRS 13, *Fair Value Measurement*

IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair values measurements when such measurements are required or permitted by other IFRSs. It unifies the definition of fair values as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It replaces and expands the disclosure requirements about fair value measurements in other IFRSs, including IFRS 7. As a result, Western has included additional disclosure in this regard (see Notes 5, 6 and 18).

In accordance with the transitional provisions of IFRS 13, Western has applied the new fair value measurement guidance prospectively and has not provided any comparative information for new disclosures. Notwithstanding the above, the change had no significant impact on the measurement of Western's assets and liabilities.

(ii) *New standards and interpretations not yet adopted*

The following amended IFRS standards are not yet effective for the year ended December 31, 2013 and have not been applied in preparing these consolidated financial statements:

IFRS 9, *Financial Instruments (2009 and 2010)*

IFRS 9 Financial Instruments (2009 and 2010) ("IFRS 9 (2009)" and "IFRS 9 (2010)") will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 (2009) uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 (2009) is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities.

IFRS 9 (2009) and IFRS 9 (2010) are effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. The impact of the adoption of this standard is still being assessed.

IAS 32, *Offsetting Financial Assets and Liabilities*

The amendments to IAS 32 which are effective for years commencing on or after January 1, 2014, clarify the guidance as to when an entity has a legally enforceable right to set off financial assets and financial liabilities, and, clarify when a settlement mechanism provides for net settlement. The Company intends to adopt the amendments to IAS 32 in its consolidated financial statements for the year commencing January 1, 2014. The Company does not expect the amendments to have a material impact on the consolidated financial statements.

(iii) *The following new or amended IFRSs became effective on January 1, 2013. However, they did not have a material impact on the annual consolidated financial statements of the Company:*

IFRS 10, Consolidated Financial Statements

IFRS 11, Joint Arrangements

IFRS 12, Disclosure of Interests in Other Entities

Amendments to IAS 28, Investments in Associates and Joint Ventures

(c) *Operating segments*

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. The Company is an integrated Canadian forest products company operating in one business segment comprised of timber harvesting, log sales and lumber manufacturing and sales in world-wide markets.

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

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(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments. Western's log and lumber products are currently sold in over 30 countries worldwide, with sales to customers in Canada, the United States, Asia and Europe representing over 95% of the Company's sales. Substantially all of Western's property, plant and equipment, biological assets and intangible assets are located in British Columbia, Canada.

(d) Foreign currency translation

Foreign currency transactions are translated into Canadian dollars using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into Canadian dollars at the exchange rate on that date. Foreign currency differences arising on translation are recognized in net income for the period. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into Canadian dollars at foreign exchange rates at the date the fair value was determined.

(e) Property, plant and equipment

All items of property, plant and equipment are measured at cost, less accumulated depreciation and accumulated impairment losses, except for land, which is measured at fair value at each reporting date.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment. The cost of replacing a component of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the component will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced component is derecognized. All other repairs and maintenance are recognized in net income for the period as incurred.

Fair value increases in the carrying amount of land are credited to other comprehensive income and included within the revaluation reserve in shareholders' equity. Fair value decreases that offset previous increases of the same item of land are recognized in other comprehensive income. All other decreases are recognized immediately in net income for the period.

Depreciation is based on the depreciable amount of an item of property, plant and equipment, which is the cost of an item, less its residual value. Depreciation is calculated using the straight-line method and is recognized in net income over the estimated useful life of each component of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives for the current and comparative periods are as follows:

- Buildings and equipment 5 – 20 years
- Logging roads 9 – 20 years

Residual values, depreciation methods and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Gains and losses on disposals are determined by comparing proceeds from disposal with the carrying amount of the item of property, plant and equipment and are recognized in net income for the period in which the disposal occurs.

(f) Biological assets

Standing timber on privately held forest land that is managed for timber production is characterized as a biological asset. Accordingly, at each reporting date, the biological asset is valued at its fair value less costs to sell with any change therein, including the impact of growth and harvest, recognized in net income for the period. Costs to sell include all costs that would be

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

Years ended December 31, 2013 and 2012

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

necessary to sell the assets. Standing timber is transferred to inventory at its fair value less costs to sell at the date the logs are removed from the forest. Land under the standing timber is measured at fair value at each balance sheet date and included in property, plant and equipment.

(g) *Intangible assets*

Crown timber tenures are the contractual arrangements between the Company and the Provincial Government whereby the Company gains the right to harvest timber. All of the Company's timber licenses are accounted for as acquired finite lived intangible assets. Accordingly, these are valued at their acquired cost less accumulated amortization and any accumulated impairment losses. Amortization is recognized on a straight-line basis over 40 years, the estimated useful life of these crown timber tenures. Amortization methods, useful lives and residual values are reviewed, and adjusted if appropriate, at each reporting date.

(h) *Impairment of non-financial assets*

Assets that are subject to amortization are tested for impairment whenever events or changes in circumstance indicate that the carrying amount may not be recoverable. An impairment loss is recognized in net income for the period for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped into cash generating units ("CGU") which are the lowest levels for which there are separately identifiable cash flows.

Impairment losses recognized in prior periods are assessed at each reporting date for any indication that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the assets' adjusted carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognized.

(i) *Inventories*

Inventory, other than supplies which are valued at specific cost, are valued at the lower of cost and net realizable value ("NRV") as described below.

- (i) Lumber by species (hemlock and balsam, Douglas fir and cedar) and facility;
- (ii) Logs by sort by end use (saw logs and pulp logs).

The cost of inventories includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

The costs of lumber produced carry an average cost of production based on the species and facility where they were produced. The costs of logs produced carry an average cost of production based on the operation where the logs are produced, determined by actual log production costs divided by production volumes.

NRV is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The NRV for logs designated for lumber production is determined on the basis of the logs being converted to lumber, and for the remaining logs it is based on market log prices.

The cost of logs transferred from biological assets (standing timber) is its fair value less costs to sell at the date of harvest.

(j) *Cash and cash equivalents*

Cash and cash equivalents include cash in bank accounts and highly liquid money market instruments with maturities of 90 days or less from the date of acquisition, and are carried at fair value.

(k) *Share capital*

The Company's authorized capital consists of an unlimited number of common shares ("the Common Shares"), an unlimited number of non-voting shares ("the Non-Voting Shares") and an unlimited number of preferred shares. Common Shares, Non-Voting Shares and preferred shares

Western Forest Products Inc.

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(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction from the proceeds, net of any tax effects.

(l) *Long-term debt*

Long-term debt is recognized initially at fair value, net of transaction costs incurred. Long-term debt is subsequently carried at amortized cost; any difference between the proceeds and the redemption value is recognized in net income for the period over the term of the long-term debt using the effective interest method.

(m) *Employee benefits*

(i) *Employee post-employment benefits*

The Company has various defined benefit and defined contribution plans that provide pension or other retirement benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. The Company also provides other post-employment benefits and pension bridging benefits to eligible retired employees. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a retirement plan under which the Company pays fixed contributions into a separate entity.

The Company's net obligation in respect of its defined benefit plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of the plan assets is deducted in arriving at the obligation. The calculation is performed annually by a qualified actuary using the projected benefit actuarial method.

When the calculation results in a benefit to the Company, the recognized asset is limited to the present value of economic benefits available in the form of any future refunds from the defined benefit plan or reductions in future contributions to the defined benefit plan. In order to calculate the present value of economic benefits, consideration is given to any minimum funding requirements that apply to any defined benefit plan.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in other comprehensive income. The Company determines the net interest expense (income) on the net defined liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined liability, taking into account any changes in the net defined benefit liability during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in net income.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in net income. The Company recognizes gains and losses on settlement of a defined benefit plan when the settlement occurs.

For hourly employees covered by forest industry union defined benefit pension plans, the Company's contributions as required under the collective agreements are charged to net income for the period.

For Western's defined contribution plan, the Company makes contributions (currently, 7% of employee earnings) to privately administered investment funds on behalf of the plan members. The Company has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense in net income for the period during which services are rendered by employees. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

(ii) *Termination benefits*

Termination benefits are payable when employment is terminated before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. The

Western Forest Products Inc.

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Years ended December 31, 2013 and 2012

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

Company recognizes termination benefits in net income for the period when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. If the benefits are payable more than 12 months after the balance sheet date then they are discounted to their present value.

(iii) *Short-term employee benefits*

Short-term employee benefit obligations, including bonus plans, are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(iv) *Share-based payment transactions*

The Company has established share-based payment plans for eligible directors, officers and employees and accounts for these plans using the fair value method. The grant-date fair value of options is recognized as an employee expense, with a corresponding increase in equity, over the period that the individual becomes unconditionally entitled to the awards. The fair value of the options is determined using either the Black-Scholes or the Hull-White option pricing models which take into account, as of the grant date, the exercise price, the expected life of the options, the current price of the underlying stock and its expected volatility, expected dividends on the shares, and the risk-free interest rate over the expected life of the option. In the case of options issued since 2009, the options are only exercisable when the share price exceeds a barrier price of \$0.70 for 60 consecutive days on a volume weighted average price basis. With this additional requirement for the share price to exceed a minimum level before the options become exercisable, it is necessary to utilize the Hull-White model as the Black-Scholes model used for valuing earlier granted options is no longer applicable. All options which were previously granted and do not contain the minimum price requirement continue to be valued using the Black-Scholes model. Inherent in all option pricing models is the use of highly subjective estimates, including expected volatility of the underlying shares. The Company bases its estimates of volatility on historical share prices of the Company itself as well as those of comparable companies with longer trading histories. Cash consideration received from employees when they exercise the options is credited to share capital, as is the previously calculated fair value included in contributed surplus.

The grant-date fair value of the amount payable to eligible directors, officers and employees in respect of deferred share units ("DSUs"), which are cash-settled, is recognized as an employee expense with a corresponding increase in liabilities, over the period that the individuals become unconditionally entitled to payment. The liabilities are re-measured at fair value at each reporting date and at settlement date. Any changes in the fair value of the liabilities are recognized in employee expenses in net income for the period.

(n) *Silviculture provision*

The Company's provision for silviculture relates to the obligation for reforestation on Crown land and arises as timber is harvested. Reforestation on private timberlands is expensed as incurred. The Company recognizes a provision for silviculture at fair value in the period in which the legal obligation is incurred, with the fair value of the liability at the reporting date determined with reference to the present value of estimated future cash flows. The pre-tax discount rate used to determine the present value reflects current market assessments of the time value of money and the risks specific to the liability. The actual discount rate used reflects the current risk-free rate given that risks are incorporated into the future cash flow estimates. In periods subsequent to the initial measurement, changes in the liability resulting from revisions to estimated future cost are recognized in cost of sales within net income for the period as they occur. The unwinding of the discount associated with the provision to reflect the passage of time is included in finance costs within net income for the period.

(o) *Revenue recognition*

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of rebates and discounts, and after eliminating intercompany sales. Revenue is

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recognized as soon as the substantial risks and rewards of ownership transfer from the Company to the customer. The timing of the transfers of risks and rewards varies depending on the individual terms of the contract of sale. Lumber and by-product sales are recorded at the time product is shipped and the collection of the amounts is reasonably assured. Consistent with industry practice, log sales are recorded when the customer's order is firm, the logs have been delivered to the transfer location and the collectability of the amount is reasonably assured.

Amounts charged to customers for shipping and handling are recognized as revenue and shipping and handling costs, lumber duties, and export taxes incurred by the Company are recorded in costs and expenses.

(p) *Deferred revenue*

Deferred revenue is the result of the contractual obligations incurred upon the acquisition of the Englewood Logging Operation in March 2006, and calls for Western to deliver a specified volume of fibre (chips and pulp logs) over the term of the contract. Accordingly, the deferred revenue is amortized into net income for the period on a straight-line basis over 40 years, being the term of the related fibre supply contract.

(q) *Leases*

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases and payments made under operating leases are recognized in net income for the period on a straight line basis over the period of the lease.

(r) *Finance costs*

Finance costs comprise interest expense on long-term debt and the revolving credit facility, amortization of deferred financing costs, unwinding of the discount on the silviculture provision, changes in the fair value of investments recognized immediately through net income and net interest on the net defined benefit plan obligation. All finance costs are recognized in net income during the period using the effective interest method with the exception of the net interest on the net defined benefit obligation which is recognized as described in Note 3(b)(i).

(s) *Financial instruments*

(i) *Non-derivative financial assets*

The Company classifies its financial assets in the following categories: at fair value through profit and loss, loans and receivables, held-to-maturity and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

The Company initially recognizes loans and receivables on the date that they are originated. All other financial assets are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial asset when the contractual cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if it eliminates or significantly reduces an accounting mismatch, the Company manages such investments or makes purchase and sale decisions based on their fair value in accordance with the Company's documented risk management or investment strategy or the financial asset contains one or more embedded derivatives. Upon initial recognition, attributable transaction costs are recognized in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in net income. Financial assets at fair value through profit or loss are comprised of certain investments and forward exchange contracts.

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Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses. Loans and receivables comprise cash and cash equivalents, trade and other receivables. Cash and cash equivalents comprises cash balances and short-term investments with original maturities of 90 days or less.

Held-to-maturity financial assets are debt securities for which the Company has the positive intent and ability to hold to maturity. Held-to-maturity financial assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, held-to-maturity financial assets are measured at amortized cost using the effective interest method, less any impairment losses. Held-to-maturity financial assets include certain investments held by the Company.

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale and that are not classified in any of the previous categories. Available-for-sale financial assets are measured at fair value and changes therein, other than impairment losses and foreign currency differences on available-for-sale debt instruments, are recognized in other comprehensive income and presented within equity in the fair value reserve. When an investment is derecognized, the cumulative gain or loss in other comprehensive income is transferred to net income. The Company does not have any financial assets classified as available-for-sale.

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

The Company considers evidence of impairment for receivables and held-to-maturity financial assets at both a specific asset and collective level. All individually significant receivables and held-to-maturity financial assets are assessed for specific impairment. All individually significant receivables and held-to-maturity financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Receivables and held-to-maturity financial assets that are not individually significant are collectively assessed for impairment by grouping together receivables and held-to-maturity financial assets with similar risk characteristics.

In assessing for impairment at the collective level, the Company uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for Management's judgement for current economic and credit conditions.

An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in net income for the period and reflected in an allowance against receivables. Interest on impaired assets continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through net income.

Impairment losses on available-for-sale financial assets are recognized by transferring the cumulative loss that has been recognized in other comprehensive income, and presented in unrealized gains/losses on available-for-sale financial assets in equity, to net income. The cumulative loss that is removed from other comprehensive income and recognized in net income is the difference between the acquisition cost, net of any principal repayment and amortization, and the current fair value, less any impairment loss previously recognized in net income. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

(ii) *Non-derivative financial liabilities*

The Company classifies its financial liabilities as fair value through profit or loss or other financial liabilities.

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The Company initially recognizes debt issued on the date that it is originated. The Company derecognizes a financial liability when its contractual obligations are discharged, cancelled, or expire. The Company's non-derivative financial liabilities consist of long-term debt, the revolving credit facility as well as accounts payable and accrued liabilities. These financial liabilities are classified as other financial liabilities and are recognized initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

(iii) *Derivative financial instruments*

The Company may enter into derivative financial instruments (foreign currency forward contracts) in order to mitigate its exposure to foreign exchange risk. The Company's policy is not to use derivative financial instruments for trading or speculative purposes. These instruments have not been designated as hedges for accounting purposes, and they are carried on the statement of financial position at fair value with changes in value being recognized as gains or losses within sales in net income for the period.

Embedded derivatives are separated from the host contract and accounted for separately if (a) the economic characteristics and risks of the host contract and the embedded derivative are not closely related, (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and (c) the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in net income.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

(t) *Income tax*

Income tax expense comprises current and deferred income tax. It is recognized in profit or loss for the period except to the extent that it relates to items recognized either in other comprehensive income or directly in equity, in which case it is recognized in other comprehensive income or equity respectively.

(i) *Current tax*

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to tax payable or receivable in respect of the previous years. It is measured using tax rates enacted or substantively enacted at the reporting date.

(ii) *Deferred income tax*

Deferred income tax recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is not recognized if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting profit nor taxable profit.

Deferred income tax assets are recognized for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred income tax is measured at the rates that are expected to be applied to temporary differences when they reverse, using rates enacted or substantively enacted at the reporting date.

Deferred income tax assets and liabilities are offset only if certain criteria are met.

(u) *Earnings per share*

The Company presents basic and diluted earnings per share ("EPS") data for its Common Shares and other Non-Voting Shares. Basic EPS is calculated by dividing the net income attributable to

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Common and Non-Voting shareholders of the Company by the weighted average number of shares outstanding during the period. Diluted EPS is determined by adjusting the net income attributable to the shareholders and the weighted average number of shares outstanding, for the effects of all dilutive potential shares, which comprise share options granted to employees and directors.

4. Inventory

	December 31, 2013	December 31, 2012
Logs	\$ 95.8	\$ 78.9
Lumber	34.0	38.0
Supplies and other inventories	11.6	10.5
Provision for write downs	(8.9)	(10.8)
Total value of inventories	<u>\$ 132.5</u>	<u>\$ 116.6</u>
Inventory carried at net realizable value	\$ 30.5	\$ 34.6

The Company's logs and lumber inventory is pledged as security against the revolving credit facility.

During 2013, \$764.3 million (2012: \$777.8 million) of inventory was charged to cost of sales which includes a decrease to the provision for write-down to net realizable value of \$1.9 million.

5. Property, plant and equipment and intangible assets

Cost	Buildings & equipment	Logging roads	Land	Total property, plant & equipment	Intangible assets
Balance at January 1, 2012	\$ 128.1	\$ 111.5	\$ 110.7	\$ 350.3	\$ 171.1
Additions	20.9	11.1	0.6	32.6	-
Disposals	(0.8)	(0.2)	(6.1)	(7.1)	-
Balance at December 31, 2012	<u>\$ 148.2</u>	<u>\$ 122.4</u>	<u>\$ 105.2</u>	<u>\$ 375.8</u>	<u>\$ 171.1</u>
Additions	43.6	15.4	-	59.0	-
Disposals	(1.3)	-	(1.4)	(2.7)	(0.2)
Balance at December 31, 2013	<u>\$ 190.5</u>	<u>\$ 137.8</u>	<u>\$ 103.8</u>	<u>\$ 432.1</u>	<u>\$ 170.9</u>
Accumulated amortization and impairments					
Balance at January 1, 2012	\$ 80.1	\$ 79.9	\$ -	\$ 160.0	\$ 54.5
Amortization	10.5	11.9	-	22.4	3.4
Disposals	(0.7)	(0.1)	-	(0.8)	-
Reversal of impairments	-	-	-	-	(12.9)
Balance at December 31, 2012	<u>\$ 89.9</u>	<u>\$ 91.7</u>	<u>\$ -</u>	<u>\$ 181.6</u>	<u>\$ 45.0</u>
Amortization	11.7	13.8	-	25.5	3.7
Disposals	(1.0)	-	-	(1.0)	(0.1)
Reversal of impairments	-	-	-	-	(8.2)
Balance at December 31, 2013	<u>\$ 100.6</u>	<u>\$ 105.5</u>	<u>\$ -</u>	<u>\$ 206.1</u>	<u>\$ 40.4</u>
Carrying amounts					
At December 31, 2012	\$ 58.3	\$ 30.7	\$ 105.2	\$ 194.2	\$ 126.1
At December 31, 2013	<u>\$ 89.9</u>	<u>\$ 32.3</u>	<u>\$ 103.8</u>	<u>\$ 226.0</u>	<u>\$ 130.5</u>

(a) Intangible assets

Intangible assets are comprised entirely of the Company's Crown timber tenures and are considered to be finite lived intangible assets with an estimated useful life of 40 years.

Due to the global economic situation and the potential impact on lumber demand and prices in the market, Management determined that a review of the recoverable amount of the Company's Crown timber tenures was appropriate at December 31, 2013 and 2012.

Management considers that the aggregate of all its Crown timber tenures constitute a CGU and so tested the recoverable amount of the CGU, which was based on value in use, with the assistance of an independent valuator.

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5. Property, plant and equipment and intangible assets (continued)

Value in use was determined by discounting the future cash flows expected to be generated from the continuing use of the CGU. Unless indicated otherwise, value in use in 2013 was determined similarly as in 2012. The calculation of the value in use was determined based on the following key assumptions:

- Cash flows were projected based on historical and forecasted logging activity levels as estimated by Management while working within the constraints of the annual allowable cut levels imposed by the Chief Forester of British Columbia. Management has assumed a 25 year forecast period given the renewability of the licences and the long term nature of the business.
- Log price assumptions used in the projections were based upon consideration of historical actual log prices and long term trend pricing analysis for the Vancouver log market and export log market as published by third party analysts and independent valuers. In the December 31, 2013 estimate of value in use, log prices were expected to increase by 1% for the first 10 years and at 1.5% thereafter; an average inflation cost increase of 2.0% was assumed for the first 10 years, reducing to 1% for the next 10 years, and to 0% for the remaining 5 years. Similar overall assumptions were used in the forecast prepared for December 31, 2012.
- Cash flows for operating costs associated with the crown timber tenures were assumed to be consistent with past experience, actual operating results and are assumed to grow in line with increases in log pricing.
- A pre-tax discount rate of 9.0% (2012: 10.5%) was used in determining the recoverable amount of the CGU.
- A terminal value was determined by assuming a perpetual series of cash flows discounted at a pre-tax discount rate of 10.0% (2012: 10.5%).

As a result of the value in use assessment performed for the CGU as at December 31, 2013, a reversal of \$8.2 million of the impairment loss recorded in previous periods was recognized in profit and loss for the year ended December 31, 2013 (2012: \$12.9 million). The reversal was the result of increases to forecast cash flow margins generated from the Crown timber tenures, due primarily to a stronger worldwide market for logs and the resultant improved pricing assumptions in 2013 compared to 2012.

(b) Land

As described in Note 3(e), the Company has elected to measure land at fair value at each reporting date. The fair value measurement for the Company's land holdings of \$103.8 million has been categorized as a Level 3 fair value based on the inputs to the valuation technique used, which is a market comparison technique. The assumptions used in the valuation were based on consideration of the market price per hectare of comparable land sales. The estimated fair value of the land would increase (decrease) by \$1.0 million if the estimated average pricing were higher (lower) by 1%.

As a result of the fair value assessment of the land holdings at December 31, 2013 and 2012, no fair value adjustments were identified as the carrying value did not differ materially from the estimated fair value.

If land was stated on an historical cost basis, the carrying value would be as follows:

	December 31, 2013	December 31, 2012
Cost	\$ 79.6	\$ 80.2

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6. Biological assets

(a) Reconciliation of carrying amount

	Year ended December 31,	
	2013	2012
Carrying value, beginning of year	\$ 60.8	\$ 59.4
Acquisition of biological assets in the year	-	(2.6)
Disposition of biological assets in the year	(0.1)	5.6
Change in fair value less costs to sell	-	(1.2)
Change in fair value resulting from growth and pricing	2.7	1.6
Harvested timber transferred to inventory during the year	(5.0)	(2.0)
Carrying value, end of year	\$ 58.4	\$ 60.8

Under IAS 41, *Agriculture*, the Company's private timberlands are classified as a growing forest, with the standing timber recorded as a biological asset at fair value less costs to sell at each reporting date. The land underlying the standing timber is considered a component of property, plant and equipment, which the Company has elected to record at fair value at each reporting date (Note 5).

At December 31, 2013, private timberlands comprised an area of approximately 23,293 hectares (December 31, 2012: 23,493 hectares) of land owned by the Company; standing timber on these timberlands ranged from newly planted cut-blocks to old-growth forests. During the year ended December 31, 2013, the Company harvested and scaled approximately 265,500 cubic metres of logs from its private timberlands, which had a fair value less costs to sell of \$23.6 million at the date of harvest (2012: 201,700 cubic metres and \$15.9 million, respectively).

(b) Measurement of fair values

The fair value measurements for the Company's standing timber of \$58.4 million has been categorized as Level 3 fair value based on the inputs to the valuation technique used as discussed below. The table above shows a reconciliation from the opening balances to the closing balances for Level 3 fair values. The change in fair value resulting from price and growth is reflected in cost of goods sold.

The valuation technique used in measuring fair value and the significant unobservable inputs used are described below:

- *Valuation technique*

Discounted cash flows – the valuation model considers the present value of the net cash flows expected to be generated from the standing timber. The cash flow projections include specific estimates for 25 years. The expected cash flows are discounted using a risk-adjusted discount rate.

Market comparison technique – in addition to the discounted cash flow technique, the valuation considers the market price of comparable standing timber sales.

- *Significant unobservable inputs*

Estimated future log prices – future log price assumptions used in the valuation model consider the Company's historical actual log prices as well as consideration of forecast pricing trends published by third party analysts and an independent valuator. Estimated future log prices range from \$95 - \$117/cubic metre (weighted average of \$108/cubic metre). The estimated fair value of standing timber would increase (decrease) by \$14.7 million if the estimated future log prices were higher (lower) by 1%.

Estimated harvest costs – future harvest costs were assumed to be consistent with the Company's past experience and actual operating results. Estimated harvest costs range from \$60-\$86/cubic metre (weighted average of \$78/cubic metre). The estimated fair value of standing timber would increase (decrease) by \$9.8 million if the estimated harvest costs were lower (higher) by 1%.

Risk-adjusted discount rate – a risk-adjusted discount rate of 8% has been applied to the estimated future cash flows in arriving at the net present value of the standing timber at December 31, 2013 (2012: 5.9%). This discount rate has been determined by an independent valuator with reference to the Company's market determined discount rate for this asset type. The estimated

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6. Biological assets (continued)

fair value of standing timber would increase by \$5.1 million if the discount rate was lower by 1%, and decrease by \$4.3 million if the rate were higher by 1%.

Harvest volume – harvest volumes range from 101,000-202,000 cubic metres per year (weighted average of 145,000 cubic metres) and they represent the estimated future volume and current standing volume to be harvested over the sustainable life of the private timberlands. The estimated fair value of standing timber would increase (decrease) by \$0.5 million if the estimated harvest volume increased (decreased) by 1% per year.

(c) Risk management strategies related to biological assets

Western is exposed to the following risks relating to its private timberlands:

- The Company is exposed to risks arising from fluctuations in log prices and sales volumes. When possible, Western aligns its harvest volumes to market supply and demand, and performs regular industry trend analyses for projected harvest volumes and pricing in order to manage its risk.
- The standing timber is exposed to risk of damage as a result of severe weather conditions, forest fires, insect infestation and disease. Western has processes and procedures in place to monitor and mitigate these risks, including fire management strategies and regular inspection for pest infestation.

7. Other assets

	December 31, 2013	December 31, 2012
Investments	\$ 8.2	\$ 7.9
Discontinued operations (equipment) (Note 22)	2.8	2.2
Other	0.9	2.6
	<u>\$ 11.9</u>	<u>\$ 12.7</u>

8. Revolving credit facility

The Company's revolving credit facility (the "Facility") provides for a maximum borrowing amount of \$125.0 million, subject to a borrowing base, which is primarily based on eligible accounts receivable and inventory balances. The Facility bears interest at Canadian Prime plus 0.50% (if availability exceeds \$40.0 million) or 0.75% (if availability is less than \$40.0 million) or at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans plus 2.25% or 2.50%, dependent on the same availability criteria. The interest rate for the Facility was 3.50% at December 31, 2013 (December 31, 2012: 3.50%).

The Facility is secured by a first lien interest over accounts receivable and inventory and includes financial covenants (see Note 14). At December 31, 2013, the Facility was unused (December 31, 2012: nil) and \$100.1 million of the facility was available to the Company.

The Facility matures on December 14, 2015, subject to any future refinancing requirements of its revolving term loan.

9. Long-term debt

On June 28, 2013, the Company extended the maturity date of its existing \$110.0 million revolving term loan facility (the "Term Loan") from June 28, 2016 to June 29, 2017. Under the terms of the new arrangement, certain financial covenants have been amended to allow the Company to make distributions to its shareholders, not to exceed \$150.0 million in aggregate, available until June 30, 2014 (see Note 13). Interest rate terms remain unchanged as a result of the amendment to the Term Loan. The amendment with respect to the Term Loan provides that if Brookfield Corporation or its affiliates cease to own at least 30% of the issued shares, any undrawn portion of the Term Loan will cease to be available and the revolving loan will convert to a term loan amortized over a 10 year period repayable in equal quarterly instalments.

The Term Loan bears interest at an index rate, determined as the higher of (i) the Canadian Prime rate, and (ii) the 30 day Banker's Acceptance ("BA") rate plus 1.35%, plus the applicable index rate

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9. Long-term debt (continued)

margin which ranges from 1.75% to 3.25%, or at the Company's election, the applicable BA rate, plus the applicable BA rate margin which ranges from 2.75% to 4.25%. The applicable margin is grid-based, determined quarterly, and based on a leverage ratio calculated as the ratio of total debt to EBITDA for the trailing twelve months ending on the date of determination. The interest rate for the Term Loan was 3.97% at December 31, 2013 (December 31, 2012: 4.75%).

The Term Loan is secured by a first lien interest over all of the Company's properties and assets, excluding those of the Englewood Logging Division and all accounts receivable and inventory, over which it has second lien interests, and includes financial covenants (see Note 14).

	December 31, 2013	December 31, 2012
Revolving term loan	\$ 89.8	\$ 34.8
Less transaction costs	(1.3)	(1.0)
	<u>\$ 88.5</u>	<u>\$ 33.8</u>

The transaction costs at December 31, 2013 relate to the new financing arrangements completed in the second quarter of 2012 and the amendment made to the Term Loan on June 28, 2013. These costs are deferred and being amortized to finance costs over the term of the amended revolving Term Loan using the effective interest rate method.

10. Income taxes

	Year ended December 31,	
	2013	2012
		[Restated - Note 17]
Current tax expense		
Current period	\$ 0.3	\$ 0.1
Adjustment for prior periods	-	-
	<u>\$ 0.3</u>	<u>\$ 0.1</u>
Deferred income tax recovery		
Origination and reversal of temporary differences	\$ 30.9	\$ 3.3
Difference in tax rates	(4.2)	-
Recognition of previously unrecognized tax losses	(26.5)	-
Change in unrecognized deductible temporary differences	(26.7)	(3.3)
	<u>\$ (26.5)</u>	<u>\$ -</u>
Total income tax (recovery) expense	<u>\$ (26.2)</u>	<u>\$ 0.1</u>

Income tax (recovery) expense differs from the amount that would be computed by applying the Company's combined Federal and Provincial statutory rate as follows:

	Year ended December 31, 2013		Year ended December 31, 2012	
			[Restated - Note 17]	
		\$	\$	\$
Income before income taxes, continuing operations		99.7	29.4	
Tax using the Company's domestic tax rate	25.75%	25.7	25.00%	7.4
Difference in tax rates	(4.21%)	(4.2)	0.68%	0.2
Over (under) provided for in prior periods	(0.10%)	(0.1)	1.02%	0.3
Other permanent differences	5.62%	5.6	(15.31%)	(4.5)
Recognition of previously unrecognized tax losses	(26.58%)	(26.5)	0.00%	-
Change in unrecognized deductible temporary differences	(26.78%)	(26.7)	(11.22%)	(3.3)
	<u>(26.31%)</u>	<u>\$ (26.2)</u>	<u>0.17%</u>	<u>\$ 0.1</u>

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10. Income taxes (continued)

The components of deferred income tax are as follows:

	Opening Balance	Recognized in profit or loss	Ending Balance
For the Year ended December 31, 2013			
Deferred income tax assets			
Tax loss carry-forwards	\$ 18.1	\$ 31.7	\$ 49.8
Provisions	10.3	(0.5)	9.8
Property, plant and equipment	5.5	1.0	6.5
	<u>33.9</u>	<u>32.2</u>	<u>66.1</u>
Deferred income tax liabilities			
Intangible assets	(27.0)	(4.7)	(31.7)
Biological assets	(6.9)	(1.0)	(7.9)
	<u>(33.9)</u>	<u>(5.7)</u>	<u>(39.6)</u>
Total	<u>\$ -</u>	<u>\$ 26.5</u>	<u>\$ 26.5</u>
For the Year ended December 31, 2012			
Deferred income tax assets			
Tax loss carry-forwards	\$ 16.3	\$ 1.8	\$ 18.1
Provisions	9.8	0.5	10.3
Property, plant and equipment	7.2	(1.7)	5.5
	<u>33.3</u>	<u>0.6</u>	<u>33.9</u>
Deferred income tax liabilities			
Intangible assets	(25.9)	(1.1)	(27.0)
Biological assets	(7.4)	0.5	(6.9)
	<u>(33.3)</u>	<u>(0.6)</u>	<u>(33.9)</u>
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The Company has recognized and unrecognized deferred income tax assets in relation to unused tax losses that are available to carry forward against future taxable income. At December 31, 2013, the Company and its subsidiaries have unused non-capital tax losses carried forward of approximately \$308.2 million (2012: \$393.4 million), which expire between 2027 and 2033, available to reduce taxable income, and capital losses of approximately \$121.7 million (2012: \$124.4 million) available to be utilized against capital gains.

During 2013, the Company recognized a deferred income tax asset on non-capital losses that are probable to be utilized. Although the Company anticipates realizing the full benefit of the loss carry-forwards and other deferred income tax assets that remain unrecognized, the timing of recognition of these remaining deferred tax assets in excess of its deferred tax liabilities will depend on on-going assessments of economic conditions, and that the likelihood of utilizing the loss carry forwards is probable. Deferred income tax assets have not been recognized in respect of the following loss carry-forwards and other deductible temporary differences:

	December 31, 2013	December 31, 2012
Non-Capital Loss Carry Forwards	\$ 116.6	\$ 321.0
Capital Loss Carry Forwards	121.7	124.4
Employee post-retirement benefits obligation	18.3	33.2
	<u>\$ 256.6</u>	<u>\$ 478.6</u>

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11. Other liabilities

	December 31, 2013	December 31, 2012
Employee post-retirement benefits obligation ^(Note 17)	\$ 18.3	\$ 33.2
Environmental accruals, excluding non-continuing operations	1.5	1.5
Other	0.5	0.9
	<u>\$ 20.3</u>	<u>\$ 35.6</u>

12. Silviculture provision

The Company has a responsibility to reforest timber harvested under various timber rights. Changes in the silviculture provision are as follows:

	Year ended December 31,	
	2013	2012
Silviculture provision, beginning of year	\$ 31.0	\$ 30.9
Silviculture provision charged	10.4	11.9
Silviculture work payments	(11.7)	(10.7)
Disposition of intangible assets	-	(1.4)
Unwind of discount	0.3	0.3
Silviculture provision, end of year	30.0	31.0
Less current portion	12.3	13.4
	<u>\$ 17.7</u>	<u>\$ 17.6</u>

The silviculture expenditures are expected to occur over the next one to ten years and have been discounted at risk-free rates of 1.00% to 2.76%. The total undiscounted amount of the estimated future expenditures required to settle the silviculture obligation at December 31, 2013 is \$31.7 million (December 31, 2012: \$32.2 million). Reforestation expense incurred on current production is included in production costs and the unwinding of discount, or accretion cost, is included in finance costs for the year.

13. Share capital

(a) Authorized and issued share capital:

The Company's authorized capital consists of an unlimited number of Common Shares, an unlimited number of Non-Voting Shares and an unlimited number of preferred shares. The Common Shares entitle the holders thereof to one vote per share. The Non-Voting Shares do not entitle the holders to any votes at meetings of the Company's shareholders except that they will be entitled to one vote per share relating to certain matters including liquidation, dissolution and winding-up. The Common Shares and Non-Voting Shares rank equally as to participation in a distribution of the assets of the Company on a liquidation, dissolution or winding-up of the Company and as to the entitlement to dividends.

The holders of the Non-Voting Shares have certain registration rights that enable them to require the Company to assist them with a public offering of the Non-Voting Shares or Common Shares for which the Non-Voting Shares may be exchanged, subject to certain limitations.

Issued and outstanding Common and Non-Voting Shares are as follows:

	Number of Common Shares		Amount		Number of Non-Voting Shares		Amount	
Balance at January 1, 2012	128,625,623	\$ 412.3	338,945,860	\$ 187.5				
Exercise of stock options	480,000	0.2	-	-				
Conversion of non-voting shares to common shares	122,112,801	67.2	(122,112,801)	(67.2)				
Balance at December 31, 2012	<u>251,218,424</u>	<u>\$ 479.7</u>	<u>216,833,059</u>	<u>\$ 120.3</u>				
Repurchase of shares	(27,060,434)	(35.3)	(49,862,642)	(65.0)				
Conversion of non-voting shares to common shares	127,919,820	42.2	(127,919,820)	(42.2)				
Balance at December 31, 2013	<u>352,077,810</u>	<u>\$ 486.6</u>	<u>39,050,597</u>	<u>\$ 13.1</u>				

On August 16, 2013, the Company closed a substantial issuer bid, repurchasing a total of 76,923,076 Shares for a purchase price of \$1.30 per share, for aggregate consideration of \$100.3 million, paid in

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13. Share capital (continued)

cash from funds drawn on its Term Loan. These shares represented approximately 16% of the total number of Shares issued and outstanding as of August 16, 2013. 76,914,830 of the Shares were repurchased from Brookfield Special Situations Management Limited (“BSSML”) for consideration of approximately \$100.0 million, excluding transaction costs. Immediately following the repurchase, the Company converted 36,800,000 Non-Voting Shares held by BSSML, on a one-for-one basis, into Common Shares of the Company.

On October 9, 2013, on closing of a secondary offering of the Company’s shares by BSSML, 46,000,000 Non-Voting Shares were converted, on a one-for-one basis, into Common Shares of the Company. Immediately following completion of the secondary offering, 45,119,820 of the remaining

Non-Voting Shares held by BSSML were converted on a one-for-one basis into Common Shares of the Company.

As at December 31, 2013, BSSML beneficially held 172,506,977 Common Shares, representing 49% of the 352,077,810 issued and outstanding Common Shares of Western, and 100% of the 39,050,597 Non-Voting Shares issued and outstanding (see Note 25).

(b) Stock-based compensation plan:

The Company has an incentive stock option plan (the “Option Plan”), which permits the granting of options to eligible participants to purchase up to an aggregate of 20,000,000 Common Shares. During 2013, the Company recorded compensation expense of \$2.3 million (2012: \$0.9 million) which has been credited to contributed surplus. Each option is exercisable, subject to vesting terms of 20% per year and immediately upon a change in control of the Company, into one Common Share, subject to adjustments, at a price of not less than the closing price of the Common Shares on the TSX on the day immediately preceding the grant date. Options granted under the Option Plan expire, a maximum of ten years from the date of the grant.

During the year, the Company granted 3,500,000 options with a fair value of \$3.1 million as determined by the Hull-White option pricing model using the assumptions of a weighted average exercise price of \$1.27, risk free interest rate of 3.4%, a volatility rate of 60.0%, and an expected life of ten years. These options are only exercisable when the share price exceeds \$0.70 for 60 consecutive days on a volume weighted average price basis. With the additional requirement for the share price to exceed a certain level before the options become exercisable it was necessary to utilize the Hull-White model. All other options outstanding that were previously granted do not contain the minimum price requirement and continue to be valued under the Black-Scholes model.

At December 31, 2013, 13,016,795 options were outstanding under the Company’s Option Plan with a weighted average exercise price of \$0.97 per Common Share.

The following table summarizes the change in the options outstanding during the years ending December 31, 2013 and 2012:

	Year ended December 31, 2013		Year ended December 31, 2012	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Outstanding, beginning of year	9,516,795	\$ 0.86	6,441,795	\$ 0.70
Granted	3,500,000	\$ 1.27	4,700,000	\$ 0.96
Exercised	-	\$ -	(480,000)	\$ (0.31)
Expired	-	\$ -	(155,000)	\$ (1.72)
Forfeited	-	\$ -	(990,000)	\$ (0.49)
Outstanding, end of year	13,016,795	\$ 0.97	9,516,795	\$ 0.86

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13. Share capital (continued)

Details of options outstanding under the Option Plan at December 31, 2013 are as follows:

Exercise price	Number outstanding December 31, 2013	Weighted average remaining option life (years)	Weighted average exercise price	Number exercisable December 31, 2013	Weighted average exercise price
\$ 0.22	2,500,000	6.2	\$ 0.22	1,500,000	\$ 0.22
\$ 0.77	1,300,000	7.2	\$ 0.77	520,000	\$ 0.77
\$ 0.95	1,800,000	8.2	\$ 0.95	360,000	\$ 0.95
\$ 0.96	2,900,000	8.6	\$ 0.96	580,000	\$ 0.96
\$ 1.20	190,000	4.4	\$ 1.20	190,000	\$ 1.20
\$ 1.27	3,500,000	9.1	\$ 1.27	-	\$ -
\$ 1.75	436,000	2.5	\$ 1.75	436,000	\$ 1.75
\$ 2.20	366,000	3.7	\$ 2.20	366,000	\$ 2.20
\$ 12.10	24,795	0.6	\$ 12.10	24,795	\$ 12.10
	<u>13,016,795</u>	<u>7.7</u>	<u>\$ 0.97</u>	<u>3,976,795</u>	<u>\$ 0.94</u>

(c) Deferred share unit plan:

The Company has a Deferred Share Unit ("DSU") Plan for directors and designated executive officers. Directors may elect to take a portion of their fees in the form of DSUs and executive officers may elect to take a portion of their annual incentive bonus in the form of DSUs. All DSU holders are entitled to DSU dividends, equivalent to the dividend they would have received if they held their DSUs as shares. For directors, the number of DSUs allotted is determined by dividing the dollar portion of the quarterly fees a director elects to take in DSUs by the share price value on the fifth day following each quarter end. For executive officers, the number of DSUs allotted is determined by dividing the dollar portion of the bonus that an executive elects to take in DSUs by the weighted average price of the Company's Common Shares for the five business days prior to the issue notification date. For dividends, the number of DSUs allotted is determined by dividing the total dollar value of the dividend each DSU holder would have received, by the average share price for the five days leading up to the dividend date of record.

During 2013, designated executive officers were allotted 121,691 DSUs at a weighted average price of \$1.33 per DSU. A further 69,153 DSUs were issued to a director at a weighted average price of \$1.43 per DSU, and 219,745 DSUs were redeemed. The cumulative number of DSUs outstanding at December 31, 2013 was 951,290 (December 31, 2012: 980,191). In 2013, the Company recorded compensation expense for these DSUs of \$0.6 million (2012: \$0.6 million), with a corresponding increase to accounts payable and accrued liabilities.

(d) Warrants

On October 9, 2013, the Company issued 46,000,000 warrants in connection with the completion of the secondary offering of 46,000,000 of the Company's shares by BSSML on that date. Each warrant entitles the holder thereof to purchase one Common Share of the Company owned by BSSML at a price of \$1.60 until July 31, 2014. Pursuant to an agreement between the Company, BSSML and Computershare Trust Company of Canada, BSSML is required to deliver from its holdings all of the Common Shares issuable upon exercise of the warrants. As a result, no Common Shares will be issued by Western to satisfy the exercise of the warrants and Western will not receive any proceeds on exercise of the warrants. As at December 31, 2013, 46,000,000 warrants were outstanding.

(e) Earnings per share:

Basic earnings per share is calculated by dividing the net income by the weighted average number of Common Shares and Non-Voting Shares issued and outstanding over the period. Diluted net earnings per share is calculated by reference to the fully diluted weighted average number of shares outstanding as determined using the treasury stock method and considering the dilutive effect, if any, of employee stock options (Note 13(b)).

14. Capital requirements

The Company's strategy for managing capital is to maintain a capital position that provides financial flexibility and achieves growth with the objective of maximizing long-term shareholder value. Western's capital requirements typically include major new investments designed to increase net

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14. Capital requirements (continued)

income and disbursements for other new equipment and ongoing enhancements, efficiency improvements, safety, and protection or extension of the life of equipment. Significant expenditures are also required to fund new capital roads allowing access to timber stands for harvesting purposes. During 2013, capital expenditures continued to be monitored closely because of the uncertain economic climate, but spending on certain strategic capital projects has commenced because of Western's stronger financial position and growing confidence in the lumber markets.

The Company seeks to achieve a balance between the higher returns that may arise with higher levels of borrowing and the advantages and security provided by a sound capital position. The Company monitors the ratio of net debt to capitalization. Under the current market conditions the Company has increased its debt position and has a net capitalization to debt ratio of 18% as at December 31, 2013 (December 31, 2012: 4%). Net debt is defined as long-term debt plus amounts drawn on the revolving credit facility, less cash and cash equivalents. Capitalization comprises net debt and shareholders' equity.

Changes to the capital structure may be made as strategic opportunities arise. In order to maintain or adjust the capital structure, the Company may buy back shares, issue new shares, source new debt, or sell assets to reduce debt. The Company has internal controls to ensure changes to the capital structure are properly reviewed and approved.

During 2013, the Company initiated a quarterly dividend program which is being paid from operating cash flows, and is at the discretion of the Company's Board of Directors.

Since originally refinancing its term debt in March of 2008, the Company has repaid a total of \$185.2 million of the term loans, substantially from the cash proceeds of disposition of non-core assets. Pursuant to the extension of the Term Loan agreement completed on June 28, 2013 (Note 9), term debt repayments will continue as non-core asset sales are realized or if surplus cash generated from operations is available.

Under the current financing agreements, the Company is subject to financial covenants. The Facility contains two financial covenants: (i) minimum consolidated adjusted shareholders' equity of \$200.0 million; and (ii) should availability fall below \$10.0 million or in the event of default, minimum fixed charge coverage ratio of 1.1:1.0. The Term Loan contains two financial covenants: (i) maximum loan to value ratio of 50% (loans are defined as the total term loans outstanding and value is defined as the appraised value of our Crown tenures and private timberlands; this financial covenant is measured on the last day of each fiscal year and at the time of consummation of a sale or disposition of assets, with certain exceptions) and (ii) maximum funded debt to capitalization of 0.45 to 1.0, measured on a quarterly basis. As at December 31, 2013, the Company is in compliance with all financial covenants, and expects to be in compliance for the next 12 months.

The Term Loan provides that if Brookfield Corporation or its affiliates cease to own at least 30% of the issued shares, any undrawn portion of the Term Loan will cease to be available and the revolving loan will convert to a term loan amortized over a 10 year period repayable in equal quarterly instalments.

The Company is not subject to any statutory capital requirements. Under the Company's stock-based compensation plan, commitments exist to issue common shares.

There were no changes to the Company's approach to managing capital during the year.

15. Commitments and contingencies

(a) Lumber duties and export tax

Under the softwood lumber agreement ("SLA") between Canada and the United States, the Company's exports to the United States are assessed an export tax by the Canadian Government. The SLA, which became effective October 12, 2006, has a term of seven years with provision for an extension of two years and for early termination by either Government after two years. On January 23, 2012 the agreement was extended by two years and now terminates in October, 2015. The export tax rate varies according to the price of lumber based on the "Random Lengths Framing Lumber Composite Index" ("Index") and ranges from zero percent when the Index is above US\$355 per thousand board feet to 15% when the Index is under US\$315 per thousand board feet.

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15. Commitments and contingencies (continued)

The export tax only applies to the first US\$500 per thousand board feet for any product sales. In addition, if the monthly volume of exports from the British Columbia coastal region exceeds a certain "Trigger Volume" as defined in the SLA, a "surge" mechanism will apply to increase the rate of the export tax for that month by 50% (for example, the 15% export tax rate would become 22.5% for that month). During 2013, the Company recorded an expense of \$0.9 million (2012: \$6.0 million). While shipment volumes to the US were relatively unchanged for 2013 compared to 2012, export taxes were lower as prices were higher on average in 2013, leading to a lower export tax rate being applicable for certain periods.

(b) Litigation and claims

In the normal course of its business activities, the Company may be subject to a number of claims and legal actions that may be made by customers, unions, suppliers and others in respect of which either provision has been made or for which no material liability is expected. The Company has claims filed against it from logging contractors and unions with respect to various operating issues. Certain of the claims are pending mediation or arbitration, while others have not yet reached this formal stage. Where the Company is not able to determine the outcome of these disputes no amounts have been accrued in these financial statements.

(c) Long-term fibre supply agreements

The Company has a number of long-term commitments to supply fibre to third parties including a 40 year agreement, entered into on March 17, 2006 ("40 Year Agreement"). As consideration for entering into the 40 Year Agreement, the Company received a price premium of \$80.0 million that will be earned as wood chips are delivered under the agreement. Upon execution, a non-refundable prepayment of the price premium of \$35.0 million was received with the balance of \$45.0 million set-off against the consideration due by the Company on its acquisition of the Englewood Logging Division from the same party to the fibre supply agreement. The Company recorded the price premium as deferred revenue (Note 3(p)) and has granted a first charge over the acquired assets (including a tree farm license with an allowable annual cut of 844,000 cubic metres, 4,771 hectares of private timberlands and other capital improvements and equipment) to secure certain of these obligations.

In addition, certain of the Company's long term fibre supply agreements with third parties have minimum volume requirements and may, in the case of a failure to produce the minimum volume, require the Company to conduct whole log chipping, source the deficiency from third parties at additional cost to the Company or pay the party to the fibre supply agreement a penalty calculated based on the provisions contained in the relevant agreement. Should Western take significant market related curtailments in its sawmills, the volume of chips produced is reduced and accordingly there is greater risk that the Company may not meet its contractual obligations.

The Company has satisfied its annual fibre commitments for 2013.

(d) Operating leases

Future minimum lease payments at December 31, 2013 under operating leases were as follows:

2014	\$	3.0
2015		2.4
2016		1.7
2017		1.2
2018		1.1
	\$	<u>9.4</u>

(e) Allowable annual cut reductions

During 2012, adjustments were made to the Annual Allowable Cuts ("AAC") of three tree farm licences ("TFL"s). On February 10, 2012 the total AAC of TFL 6 was reduced from 1,255,535 cubic metres to 1,160,000 cubic metres as a result of a periodic determination by the provincial Chief Forester. Of this total volume, 1,148,422 cubic metres is held by Western and 11,578 cubic metres by the Crown. On March 15, 2012, the AAC attributable to Western for TFL 19 was reduced by 1,163 cubic metres to reflect the removal of three small parcels of Crown land as a result of a private land exchange. On May 28, 2012 a portion of TFL 39 Block 1 was deleted by the Crown in order to provide a forest tenure

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15. Commitments and contingencies (continued)

opportunity to a local First Nation. This deletion reduced the total TFL AAC by 22,000 cubic metres but did not affect Western's AAC rights within the tenure, as this AAC was already held by the Crown. Also in 2012, the Company sold TFL 60 to Taan Forest Limited Partnership ("Taan"). The AAC for the tenure at the time of transfer was 802,868 cubic metres. There were no changes to the AAC during 2013.

(f) Pension funding commitments

The Company is committed to making estimated annual special payments in relation to its salaried pension plans of \$2.3 million a year for 2013 to 2015 and \$0.8 million per year for 2016 to 2025, or until such time as a new funding valuation may lead to a change in the amount of payments required.

16. Segmented information

The Company manages its business as a single operating segment. The Company purchases and harvests logs which are then manufactured into lumber products at the Company's sawmills, or sold. Substantially all of the Company's operations and property, plant and equipment are located in British Columbia, Canada.

The Company's sales, based on the known origin of the customer, were as follows:

	Year ended December 31,	
	2013	2012
Canada	\$ 429.8	\$ 402.9
Japan	184.0	207.3
China	156.2	130.3
United States	122.0	116.4
Europe	38.7	35.6
Other	46.8	32.9
	<u>\$ 977.5</u>	<u>\$ 925.4</u>

17. Employee future benefits

The Company has several funded and unfunded defined benefit plans, a defined contribution pension plan and a group RRSP that provide retirement benefits to substantially all salaried employees and certain hourly employees. In addition, the Company provides other unfunded post-employment benefits to certain former salaried and hourly employees. The funded and unfunded defined benefit pension plans were closed to new entrants effective June 30, 2006, and effective December 31, 2010, no further benefits accrue under these plans as members became eligible to participate in the defined contribution plan. All new salaried employees are now provided with pension benefits through a defined contribution plan. The defined benefit plans are based on years of service to December 31, 2010, and final average earnings. The Company's other post-employment benefit plans are non-contributory and include a range of health care and other benefits.

Total cash payments for employee future benefits for the year ended December 31, 2013 were \$14.0 million (December 31, 2012: \$14.2 million), consisting of cash contributed by the Company to its funded pension plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to the forest industry union defined benefit plans. In relation to defined benefit plans, the Company measures the fair value of plan assets and the accrued benefit obligations for accounting purposes as at December 31 of each year. The most recent actuarial valuations of the funded defined benefit pension plans were at December 31, 2010. The next actuarial valuation for both the funded and unfunded defined benefit plans and other unfunded post-employment benefit plans will be prepared for December 31, 2013.

Impact of adoption of IAS 19R

The Company adopted IAS 19R on January 1, 2013 as described in Note 3(b)(i). As required by the standard, the new policy was adopted retrospectively. The effect of adoption on the year ended December 31, 2012 was a reduction to net income of \$0.9 million. This comprised an increase to finance costs for the year ended December 31, 2012 of \$1.3 million, and a decrease to selling and administration costs of \$0.4 million. There was a corresponding reduction in the defined benefit plan

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17. Employee future benefits (continued)

actuarial losses recognized in other comprehensive income for the year ended December 31, 2012 of \$0.9 million. The revision had no impact on net assets at December 31, 2012. The impact on earnings per share for the 12 months ended December 31, 2012 was not material.

Information about the Company's defined benefit salaried pension plans and other non-pension benefits, in aggregate, is as follows:

	December 31, 2013		December 31, 2012 [Restated]	
	Salaried Pension Plans	Non-pension Plans	Salaried Pension Plans	Non-pension Plans
Plan assets:				
Fair value, beginning of year	\$ 101.6	\$ -	\$ 97.0	\$ -
Company contributions	3.2	0.4	3.7	0.4
Benefits and administrative expenses paid	(7.8)	(0.4)	(8.2)	(0.4)
Actual return on assets	8.9	-	9.1	-
Fair value, end of year	<u>\$ 105.9</u>	<u>\$ -</u>	<u>\$ 101.6</u>	<u>\$ -</u>
Accrued benefit obligation:				
Balance, beginning of year	\$ 126.7	\$ 8.1	\$ 118.2	\$ 7.6
Current service costs and administrative expenses	0.2	-	0.3	-
Benefits and administrative expenses paid	(7.8)	(0.4)	(8.2)	(0.4)
Interest cost	5.1	0.3	5.6	0.4
Actuarial (gain) loss	(5.5)	(2.5)	10.8	0.5
Balance, end of year	<u>\$ 118.7</u>	<u>\$ 5.5</u>	<u>\$ 126.7</u>	<u>\$ 8.1</u>
Deficit recognized in Statement of Financial Position ^(Note 11)				
	<u>\$ (12.8)</u>	<u>\$ (5.5)</u>	<u>\$ (25.1)</u>	<u>\$ (8.1)</u>
Cumulative actuarial gains (losses), beginning of year	\$ (25.1)	\$ (1.4)	\$ (18.7)	\$ (0.8)
Actuarial gains (losses) recognized directly in OCI	10.4	2.5	(6.4)	(0.6)
Cumulative actuarial gains (losses), end of year	<u>\$ (14.7)</u>	<u>\$ 1.1</u>	<u>\$ (25.1)</u>	<u>\$ (1.4)</u>
Experience gains (losses):				
Experience gains (losses) on plan assets:				
Amount	\$ 4.9	n/a	\$ 4.4	n/a
Percentage of plan assets	4.58%	n/a	4.36%	n/a
Experience gains (losses) on plan liabilities:				
Amount	\$ 0.2	\$ 2.4	\$ (0.3)	\$ -
Percentage of plan assets	0.17%	43.18%	(0.25)%	0.34%

Included in the above accrued benefit obligations and plan assets for salaried pension plans are accrued benefit obligations of \$111.7 million at December 31, 2013 (December 31, 2012: \$118.9 million) in respect of plans that are wholly or partly funded.

The following is a breakdown of the pension plan assets into their major investment categories:

	December 31, 2013	December 31, 2012
Equity securities	32%	46%
Debt securities	67%	52%
Other	1%	2%
	<u>100%</u>	<u>100%</u>

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17. Employee future benefits (continued)

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations (expressed as weighted averages) are as follows:

	December 31, 2013	December 31, 2012	December 31, 2013	
			Increase (Decrease) of Accrued Benefit Obligation with Change in Assumption 1% Increase	1% Decrease
Discount rate, beginning of year for:				
Pension plans	4.19%	4.97%	n/a	n/a
Non-pension plans	4.10%	4.90%	n/a	n/a
Discount rate, end of year for:				
Pension plans	4.56%	4.19%	12,443,500	(15,129,500)
Non-pension plans	4.30%	4.10%	448,100	(516,900)
Rate of compensation increase for all plans	3.38%	3.38%	(2,455,600)	2,186,900
Health care cost trend rate	5.90% in 2014 grading to 4.35% in 2026	5.90% in 2013 grading to 4.30% in 2023	(360,900)	340,600

The Company's salaried pension and non-pension benefits expense is as follows:

	December 31, 2013		December 31, 2012	
	Salaried Pension Plans	Non-pension Plans	[Restated]	
			Salaried Pension Plans	Non-pension Plans
Defined benefit plans:				
Current service costs and administrative expenses	\$ 0.2	\$ -	\$ 0.3	\$ -
Net interest costs	1.0	0.3	0.9	0.4
Cost of defined benefit plans	1.2	0.3	1.2	0.4
Cost of defined contribution plans	2.7	-	2.5	-
Total cost of employee post-retirement benefits	\$ 3.9	\$ 0.3	\$ 3.7	\$ 0.4

The Company expects to make funding contributions to its defined benefit plans of \$2.3 million during 2014.

The Company's unionized employees are members of industry-wide pension plans to which the Company contributes a predetermined amount per hour worked by an employee. The Company's liability is limited to its contributions. The pension expense for these plans is equal to the Company's contributions and for 2013 amounted to \$8.0 million (2012: \$7.6 million).

18. Financial instruments – fair values and risk management

(a) Accounting classifications and fair values

The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair valuation hierarchy. It does not include fair value information for financial assets not measured at fair value if the carrying amount is a reasonable approximation of fair value.

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

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18. Financial instruments – fair values and risk management (continued)

	Carrying Amount					Fair Value			
	Held to maturity	Designated at fair value	Loans and receivables	Other financial liabilities	Total	Level 1	Level 2	Level 3	Total
December 31, 2013									
Financial assets measured at fair value									
Investments	\$ 5.0	\$ -	\$ -	\$ -	\$ 5.0	-	5.0	-	\$ 5.0
	<u>\$ 5.0</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5.0</u>				
Financial assets not measured at fair value									
Cash and cash equivalents	\$ -	\$ -	\$ 5.6	\$ -	\$ 5.6				
Trade and other receivables	-	-	69.0	-	69.0				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 74.6</u>	<u>\$ -</u>	<u>\$ 74.6</u>				
Financial liabilities measured at fair value									
Accounts payable and accrued liabilities	\$ -	\$ -	\$ -	\$ 79.8	\$ 79.8				
Long-term debt ^(Note 9)	-	-	-	88.5	88.5				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 168.3</u>	<u>\$ 168.3</u>				
December 31, 2012									
Financial assets measured at fair value									
Investments	\$ 4.8	\$ -	\$ -	\$ -	\$ 4.8	-	4.8	-	\$ 4.8
	<u>\$ 4.8</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4.8</u>				
Financial assets not measured at fair value									
Cash and cash equivalents	\$ -	\$ -	\$ 18.8	\$ -	\$ 18.8				
Trade and other receivables	-	-	69.5	-	69.5				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 88.3</u>	<u>\$ -</u>	<u>\$ 88.3</u>				
Financial liabilities measured at fair value									
Foreign currency forward contracts ^{(Note 18(iii))}	\$ -	\$ 0.1	\$ -	\$ -	\$ 0.1	-	0.1	-	\$ 0.1
	<u>\$ -</u>	<u>\$ 0.1</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 0.1</u>				
Financial liabilities measured at fair value									
Accounts payable and accrued liabilities	\$ -	\$ -	\$ -	\$ 74.0	\$ 74.0				
Long-term debt ^(Note 9)	-	-	-	33.8	33.8				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 107.8</u>	<u>\$ 107.8</u>				

(b) Financial risk management

The use of financial instruments exposes the Company to credit risk, liquidity risk, and market risk. Other than as described below, Management does not consider the risks to be significant to the Company.

The Board of Directors has oversight responsibility for the Company's risk management framework. The Company identifies, analyzes and actively manages the financial market risks associated with changes in foreign exchange rates, interest rates and commodity prices. Western has established risk management policies and controls to identify and analyze the risks faced by the Company, to set appropriate risk limits and to monitor risks and adherence to limits. Currently, the Company is only engaged in foreign exchange forward contract activities.

(i) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's receivable from customers, and cash and cash equivalents. The carrying amount of the Company's financial assets represents the maximum credit exposure.

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, Management also considers the demographics of the Company's customer base, including the default risk of the industry and country in which customers operate, as these factors may have an influence on credit risk. The Company has determined that there is no concentration of credit risk either geographically or by counterparty.

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18. Financial instruments – fair values and risk management (continued)

Sales transactions are made through the extension of credit to customers and are recorded at the point in time the sale is recognized. Accordingly, fluctuations in collectability may affect the carrying value of the underlying accounts receivable. Management balances the credit risk through rigorously and continually reviewing customer credit profiles. The Company has established policies and controls to review the creditworthiness of new customers, including review of credit ratings. The Company's general practice is to insure substantially all North American lumber receivables for 90% of value with the Export Development Corporation or Coface Canada, while all export sales are sold on either a cash basis or with secured instruments, which reduces the Company's exposure to bad debts.

The Company regularly reviews the collectability of accounts receivable and makes provisions where the collectability is uncertain. Historically the Company's bad debts have been minimal and as at December 31, 2013, the Company had no allowance for doubtful customer accounts (December 31, 2012: \$0.4 million).

The aging of trade and other receivables at the reporting date that were not impaired was as follows:

	December 31, 2013		December 31, 2012	
	Gross value	Impairment	Gross value	Impairment
Not past due	\$ 61.7	\$ -	\$ 65.4	\$ -
Past due, 0 - 30 days	7.2	-	2.9	-
Past due, 31 - 120 days	0.1	-	1.6	(0.4)
More than 1 year	-	-	-	-
	<u>\$ 69.0</u>	<u>\$ -</u>	<u>\$ 69.9</u>	<u>\$ (0.4)</u>

The Company held cash and cash equivalents of \$5.6 million at December 31, 2013 (December 31, 2012: \$18.8 million), which represents its maximum credit exposure on these assets. The cash and cash equivalents are held at highly rated financial institutions and as such, the Company does not believe that these are exposed to significant credit risk.

(ii) Interest rate risk

The Company is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates. Based on the Company's debt structure at December 31, 2013, a change of 1% in interest rates would have increased or decreased annual net income by approximately \$0.5 million. The Company does not currently use derivative instruments to reduce its exposure to interest rate risk.

(iii) Currency risk

Certain of the Company's sales transactions are denominated in foreign currencies, principally, the US dollar and Japanese Yen ("JPY"), and accordingly the Company is exposed to currency risk associated with changes in foreign exchange rates. To assist in mitigating this exchange risk, the Company has entered into an agreement dated March 31, 2009 with Brookfield Asset Management ("BAM") to provide a foreign exchange facility ("Facility") to the Company. The Facility, which is for a notional amount of up to US\$80.0 million, matures on March 31, 2014, and allows for forward transactions with a maximum term for each transaction of up to one year. The maturity date is subject to automatic annual renewal subject to BAM notifying the Company of its intention to cancel the facility at least 30 days prior to the anniversary date and to certain change of control provisions being invoked. The Facility is unsecured and is subject to a fee of 0.10% of the notional amount per annum. The Company does not consider the credit risk associated with this Facility to be significant.

During 2013, the Company entered into contracts under the facility to sell US dollars and JPY forward in order to mitigate a portion of this foreign currency risk. At December 31, 2013, the Company had outstanding obligations to sell an aggregate US\$11.0 million at an average exchange rate of CAD\$1.0619 per US dollar with maturities through February 27, 2014, and to sell JPY 100 million at a rate of JPY 94.62 per CAD dollar with a maturity date of January 31, 2014.

All foreign currency gains and losses to December 31, 2013 have been recognized in sales in the consolidated statement of comprehensive income and the fair value of these instruments at December 31, 2013 was a net liability of \$nil which is included in accounts payable and accrued liabilities on the consolidated statement of financial position (December 31, 2012: \$0.1

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

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(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

18. Financial instruments – fair values and risk management (continued)

million). A net loss of \$0.1 million (2012: net gain of \$2.7 million) was recognized in sales in the consolidated statement of comprehensive income on the change in fair values of the foreign exchange contracts. An increase (decrease) of 1% in the value of the Canadian dollar as compared to the JPY would have an immaterial impact on JPY foreign exchange forward contracts held at year end. An increase (decrease) of 1% in the value of the Canadian dollar as compared to the US dollar would result in a gain (loss) of approximately \$0.1 million in relation to the US dollar foreign exchange contracts held at December 31, 2013.

Certain receivable balances at December 31, 2013 are denominated in foreign currencies, principally, the US dollar. Accordingly, fluctuations in foreign exchange rates may affect the carrying value of the underlying accounts receivable. As of December 31, 2013, the Company's accounts receivable denominated in US dollars totaled \$28.7 million. An increase (decrease) in the value of the Canadian dollar by US\$0.01 would result in a decrease (increase) in US dollar denominated accounts receivable at year end of approximately \$0.3 million. In addition, as at December 31, 2013, the Company had a total of \$7.6 million in US dollar denominated cash and cash equivalents. An increase (decrease) in the value of the Canadian dollar by US\$0.01 would result in an immaterial change to US dollar denominated cash and cash equivalents at year end.

(iv) Commodity price risk

The Company does not enter into commodity contracts other than to meet the Company's expected usage and sale requirements and such contracts are not settled net.

(v) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Management mitigates any liquidity risk associated with the subsequent payment of liabilities through the continual monitoring of expenditures and forecasting of liquidity resources. The Company maintains a revolving credit facility that can be drawn down to meet short-term financing and liquidity needs.

As at December 31, 2013, the Company had \$120.3 million (December 31, 2012: \$166.3 million) available under its credit facility and revolving term loan. The following are the contractual maturities of financial liabilities, including estimated interest payments:

	Carrying amount	Contractual cash flows	6 months or less	6 - 12 months	2 - 3 years	4 - 5 years	More than 5 years
Accounts payable and accrued liabilities	\$ 79.8	\$ 79.8	\$ 79.8	\$ -	\$ -	\$ -	\$ -
Revolving term loan	88.5	101.5	1.8	1.8	7.3	90.6	-
	<u>\$ 168.3</u>	<u>\$ 181.3</u>	<u>\$ 81.6</u>	<u>\$ 1.8</u>	<u>\$ 7.3</u>	<u>\$ 90.6</u>	<u>\$ -</u>

19. Operating restructuring items

Operating restructuring items for 2013 of \$0.7 million related to severance costs associated with restructuring activities. Operating restructuring items for 2012 of \$4.8 million primarily related to \$4.0 million expensed as a result of reorganizing harvesting operations in TFL 44 in order to improve future operating performance. The balance of \$0.8 million related to severance costs incurred with respect to departmental reorganizations.

20. Finance costs

	Year ended December 31,	
	2013	2012
Long-term debt	\$ 2.5	\$ 3.0
Net interest - defined benefit plan obligation	1.3	1.3
Revolving credit facility	0.8	0.8
Amortization of deferred financing costs	0.5	1.0
Unwind of discount on provisions	0.3	0.3
Other	-	(0.1)
	<u>\$ 5.4</u>	<u>\$ 6.3</u>

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21. Other income

Other income of \$0.3 million earned in 2013 was comprised of net gains on disposal of non-core assets of \$1.5 million, offset by demolition costs of \$1.6 million incurred during the year, and miscellaneous other income of \$0.4 million.

The significant items comprising other income of \$2.8 million in 2012 were: net gains on non-core asset disposals in the year of \$1.1 million; proceeds of \$1.1 million received as final compensation from the Province of British Columbia resulting from the creation of new protective areas in our Haida Gwaii and Central Coast operating areas; \$0.9 million received as reimbursement for engineering and other infrastructure costs associated with an area that was deleted from TFL 39 in order to provide the Sliammon First Nation with a treaty related forest tenure opportunity; and \$0.3 million related to other miscellaneous expenses.

22. Discontinued operations

In March 2006, the Company closed its Squamish pulp mill located on 212 acres on the mainland coast of British Columbia and exited the pulp business. Subsequent to the closure, the Company sold substantially all of the manufacturing assets of the mill. Ongoing costs including supervision, security and property taxes continue to be expensed as incurred. In January 2013, Western announced that it had entered into a conditional agreement for the sale of its former Woodfibre Pulp Mill site for a gross purchase price of \$25.5 million. Closing is subject to certain conditions, and Western will be responsible for the satisfactory remediation of the property to applicable environmental standards prior to closing the sale. During 2013, both parties agreed to a specific remediation plan, and a deposit of \$5.5 million was placed in trust by the purchaser and is non-refundable provided that Western completes the remediation in accordance with the terms of the sale agreement. After incurring the estimated required remediation costs, Western now anticipates receiving net proceeds from the sale and remediation of approximately \$18 million.

The following table provides additional information with respect to the discontinued operations:

	Year ended December 31,	
	2013	2012
Net loss from discontinued operations	\$ (0.5)	\$ (1.1)
Cash used in discontinued operations	\$ (3.2)	\$ (1.1)
	December 31,	December 31,
	2013	2012
Assets of discontinued operations	\$ 2.8	\$ 2.2
Liabilities of discontinued operations	\$ 5.1	\$ 7.8

23. Related parties

(a) Related party transactions

As at December 31, 2013, BSSML controls and directs 49% of the Company's Common Shares and 100% of the Non-Voting Shares. BSSML is a wholly owned subsidiary of BAM.

In addition to the related party transactions identified elsewhere in these consolidated financial statements, the Company has certain arrangements with entities related to BSSML and BAM to provide financing, acquire and sell logs, lease certain facilities, provide access to roads and other areas, and acquire services including insurance, all in the normal course and at market rates or at cost.

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23. Related parties (continued)

The following table summarizes these transactions:

	Year ended December 31,	
	2013	2012
Costs incurred for:		
Log purchases	\$ 15.8	\$ 11.5
Other	8.8	6.5
	<u>\$ 24.6</u>	<u>\$ 18.0</u>
Income received for:		
Log sales	\$ 14.8	\$ 7.9
	<u>\$ 14.8</u>	<u>\$ 7.9</u>

At December 31, 2013, \$1.2 million of the costs incurred with related parties for the year then ended were included in accounts payable and accrued liabilities (December 31, 2012: \$0.1 million) and \$0.5 million of the income received from related parties for the year then ended were included in accounts receivable (December 31, 2012: \$0.1 million).

(b) Compensation of key management personnel

The key management personnel of the Company include the executive management team and members of the Board of Directors. Key management personnel compensation comprised:

	Year ended December 31,	
	2013	2012
Salaries and directors' fees	\$ 2.9	\$ 2.7
Post-employment benefits	0.3	0.2
Share-based payments	2.3	0.9
	<u>\$ 5.5</u>	<u>\$ 3.8</u>

At December 31, 2013, \$1.2 million of the key management compensation costs incurred for the year then ended were included in accounts payable and accrued liabilities (December 31, 2012: \$0.5 million).

24. Expense categorization

Expenses by function:

	Year ended December 31,	
	2013	2012
Administration	\$ 24.4	\$ 19.1
Distribution expenses	91.5	103.7
Cost of goods sold	764.3	777.8
	<u>\$ 880.2</u>	<u>\$ 900.6</u>

Costs by nature:

	Year ended December 31,	
	2013	2012
Compensation costs	\$ 210.0	\$ 191.8
Amortization in cost of goods sold	28.3	24.6
Amortization in selling and administration	0.9	1.2
	<u>\$ 239.2</u>	<u>\$ 217.6</u>

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25. Subsequent event

On January 31, 2014, on closing of a secondary offering of the Company's shares by BSSML, the remaining 39,050,597 Non-Voting Shares of the Company were converted, on a one-for-one basis, into Common Shares of the Company. As a result of the secondary offering and further share sales by BSSML since December 31, 2013 until the date of this report, BSSML holds 156,803,374 Common Shares, representing 40.1% of the current issued and outstanding Common Shares of Western.



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